Vol. V

TRANSCRIPT OF RECORD

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Supreme Court of the United States

OCTOBER TERM, 1944

No. 296

PANHANDLE EASTERN PIPE LINE COMPANY, ILLINOIS NATURAL GAS COMPANY AND MICHIGAN GAS TRANSMISSION CORPORATION, PETITIONERS,

vs.

FEDERAL POWER COMMISSION, CITY OF DETROIT, COUNTY OF WAYNE, MICHIGAN, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR CERTIORARI FILED JULY 28, 1944.

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VOL. V.

TRANSCRIPT OF RECORD.

United States Circuit Court of Appeals

EIGHTH CIRCUIT.

No. 12,466

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vs.

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PETITION TO REVIEW AND SET ASIDE ORDER OF FEDERAL POWER COMMISSION

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At Louisburg compressor station, a new 1000 horsepower Cooper-Bessemer unit will be installed at an estimated cost of $140,000, including the cost of extending the main building, cooling tower and making certain additions to the yard piping.

At Olpe compressor station, a 1300 horsepower Worthington unit will be installed at an estimated cost of $162,500, which cost includes the necessaary additions to the main building, cooling tower and yard piping.

At Haven compressor station, a new 1300 horsepower Cooper-Bessemer unit will be installed at an estimated cost of $162,500, which figure includes the cost of building certain additions to the main building, the cooling tower and to the piping in the yard.

At Greensburg compressor station, a like unit will be installed and it is estimated that this work will also cost $162,500, which figure, as I have mentioned before, in- [fol. 6085] cludes extending the main building and building certain additions to the cooling tower and yard piping.

At Liberal compressor station two 1000 horsepower Cooper-Bessemer units will be installed at a cost of $280,000, which figure includes extending the main building, enlarging the cooling tower and the making of certain additions to the yard piping.

That constitutes all of the additions to compressor stations to be made in the year 1946. A resume of our additions at the end of that period may be of interest for the purposes of the record.

According to my figures, at the end of 1946 the total horsepower installed in our various compressor stations, beginning at Tuscola station and proceeding westward, will be as follows:

Tuscola—10,900 horsepower

Glenarm—11,000 horsepower

Pleasant Hill—11,700 horsepower

Centralia—13,000 horsepower

Houstonia—13,000 horsepower

Louisburg—13,000 horsepower

Olpe—14,300 horsepower

Haven—14,300 horsepower

Greensburg—14,300 horsepower

Liberal—14,000 horsepower.

[fol. 6086] You will note from these figures that, generally speaking the power increases from the east to the west indicating that considerable quantities of gas are delivered at various points starting at the eastern terminus of our lines and dropping off at various points in Illinois and Missouri.

Q. What will be your total daily capacity as of the end of 1946 after all of the capital additions contemplated by Exhibit 47 will have been installed?

Mr. Culton: You mean peak load?

Mr. Littman: Yes, 24-hour daily capacity which is comparable to those which you have heretofore given.

The Witness: The total sales or delivery capacity will be 457,250 M.c.f. at the conclusion of our construction in the year 1946.

By Mr. Littman:

Q. Mr. Burnham, what studies, if any, did you make to determine that it would be most economical and expedient to install these capital additions in the manner contemplated by Exhibit 47 and as described in your testimony?

A. Do you refer to the size of the pipe and such matters as that?

A. I am referring particularly to your selection of installing loop lines in a given quantity as compared to so much horsepower and, in some years, you install horsepower and no main lines.

[fol. 6087] In other words, what studies did you make to determine the precise manner and method that you have selected for the installation of these capital additions?

A. Well, if I recited all of the studies that we have made in respect to that question, it would take considerable time.

However, I will say this: That it has been our experience and our economic studies made from strictly an academic point of view with no particular designed capacity in mind, indicate that if we maintain a ratio between the suction and discharge of our compressor stations close to 1.6, that the maximum economy will result in the over-all picture of transporting this gas.

That is particularly true of main line stations. I would not say it is true of field stations and, as we make these flow studies which are the basis of my estimates, we determine the amount of looping required in each instance to approximate this ratio that I just mentioned of 1.6.

Mr. Culton: Mr. Burnham, would you tell us just exactly what that ratio means?

The Witness: As I just stated, it is the ratio of the suction to the discharge pressure.

Mr. Culton: How do you determine that?

The Witness: I beg your pardon, that is the ratio of the discharge to the suction.

[fol. 6088] Mr. Culton: Will you get it down so a layman like myself can understand it? How do you determine what that relationship is?

The Witness: I will refer to some of the testimony that I gave last year.

I mentioned the fact that when we set about to make one of these flow studies, we started at Dana, Indiana, with the given quantity of gas to be delivered at that point and with the given pressure to be maintained at that point.

By the application of certain formulae, we worked backwards down the line to the next point of gas delivery.

By Mr. Littman:

Q. Now, just there, you speak of certain formulae. What are those formulae, generally?

A. They are gas flow formulae derived from certain fundamental data which have been used by the industry

for a number of years and to which we have applied certain refinements.

Our experience has shown that the coefficients that we have applied in our calculations come very close to giving the correct answer.

Q. Are these formulae called by a name in the industry?

A. Gas pipe line flow formulae as a group or as a classification.

Now, among them are the formulae developed by T. R. [fol. 6089] Weymouth which, until a few years ago, we used exclusively. The refinement I referred to just a moment ago is an adaptation of Weymouth's Formula to more nearly fit the condition which is experienced when transporting large volumes of gas to large pipe lines and it involves the application of a coefficient developed by a physicist by the name of Nikuradse.

Nikuradse published, a few years ago, a flow formula very similar to Mr. Weymouth's Formula which involved the flow of gas or assumed the flow of gas through a perfectly smooth pipe line under perfect conditions.

By using Nikuradse's Coefficient with a correction factor which compensates for the fact we do not have a perfect line because a perfect line could not be built under any conditions for a long distance, we are able to predict within very close limits the pressure drop along our system, the suction pressures at these various compressor stations in which we are vitally interested and, of course, the pressures at the points of delivery.

Q. Can you determine from the application of those formulae precisely where to install horsepower along your system and precisely whether it is economical to install loop lines rather than compressor stations or vice versa, as a matter of economics?

A. Those formulae constitute tools to determine those things. Of course, the power will be installed at the existing [fol. 6090] compressor stations. The formula gives us the suction pressure at these stations and since our discharge pressures are limited by the maximum working pressure on the line, namely, 500 pounds per square inch gage, we, by means of comparing suction to discharge,

know how closely we are approaching the theoretical ratio of 1.6 which gives us maximum economy.

Mr. Culton: That is what I wanted you to tell us, what 1.6 represents. What two figures do you put together to get your ratio, suction pressure and discharge pressure?

The Witness: Absolute. That means suction pressure expressed in pounds absolute divided into discharge pressure in pounds absolute.

Mr. Culton: That is what I wanted you to give.

The Witness: Now, if we used a ratio or if we let the suction drop so low that a ration of 1.8 might result, the power in each of these stations would increase or the power required at these stations would increase tremendously.

That is, instead of having 14 engines in a row, say, at Liberal station, we might have as many as 25 engines in a row there and the resulting labor, maintenance, cost of fuel and such other items going into the cost of compressing the gas, would amount to a very large figure at that one station.

Well, multiply that by 12 stations and you have a situation which would increase in the transportation of gas in a very uneconomical manner.

[fol. 6091] Mr. Wheat: Do you mean increase the cost?

The Witness: What did I say?

Mr. Wheat: You said increase the transportation of gas.

The Witness: I meant to say, increase the cost of transportation of gas.

Mr. Wheat: Is the converse true, that if you had a pressure situation which resulted in a factor of 1.3 or 1.4, you would have greater cost to get your gas through?

The Witness: Yes. In that event, we would have to have tremendous investments in pipe lines in order that the suction pressure at these stations which would be operating at a ratio of 1.3 would be so high as to result in the ratio between the discharge and the suction of 1.3.

Mr. Wheat: Is this 1.6 figure a theoretical figure or something based on studies of your line which show the most economical point?

The Witness: It is both. It is based on our experience. It is based on academic studies which we have made which indicate that the ratio should be in that order.

Mr. Culton: In other words, pardon me, Mr. Littman, the same principle relates to field lines, does it also, in keeping the pressures on the most economic ratio?

The Witness: The most economic ratio in the field might not be as low as 1.6.

Mr. Culton: Whether it is 1.6 or not, is there a point [fol. 6092] in the field which you find to be the most economic point?

The Witness: There is, and that point is determined by the cost of gas used as fuel in the field and other costs that go into compressing, but principally the cost of fuel.

Mr. Culton: Then in the economical standpoint of pipe lines, it is important to keep the suction pressure at the compressor station high enough so that when it is compared to the outlet pressure, approximately that ratio will result, is that true?

The Witness: Yes, that is true.

By Mr. Littman:

Q. I note in the year 1944 you installed $6,684,100 of additions. In order to secure additional capacity of 24,650 M.c.f. for 24 hours, how do you know that it is economical to spend that much money to take on that additional capacity, or don't you know that?

A. We do know, within certain limits, of course.

Q. While you are at it, please tell me how you go about determining that.

A. I thought I had already told you because we try to stay as closely as possible to this ratio of 1.6. That results in the maximum economy in the over-all picture, according to our studies and our experience.

[fol. 6093] By Mr. Goodman:

Q. Assuming that the work has to be done, is that right?

A. Always.

Q. I see, but isn't that somewhat begging the question? ~~Doesn't~~ whether or not the work is to be done depend upon the economy of doing it?

A. As I understand the way a natural gas pipe line company is operated and I hope I understand it, you have to take care of your markets and, quite naturally, in making these economic studies, I have assumed that there will be no shortage of gas on these cold days.

Q. So that, for the purposes of giving testimony in a rate case, you proceeded to exemplify this taking care of the markets with the exhibit which you have introduced?

A. I would not say that. I say that I was handed certain estimates as to what our maximum requirements would be and I was asked to prepare studies showing the most economical way of serving those markets those quantities of gas indicated in those estimates.

Q. And your testimony is limited to that?

You did not answer.

A. Is that a question?

Q. Yes.

[fol. 6094] A. I assume that this information I have developed would be applicable to any similar situation.

Q. Well, there is nothing in your testimony to the effect that Panhandle Eastern actually contemplates doing this, is there?

A. Well, take the year 1942, we are already doing some of that work.

Q. Yes, but beyond that, you would not make a definite commitment?

A. I have already testified we have not submitted budgets nor have they been approved.

Q. In other words, the situation may arise in which it will not pay you to supply the additional gas as estimated by Mr. Morton?

A. There are a lot of things that can happen. It might come to pass that we may have to supply greater quantities than those shown by Mr. Morton's estimate.

In that event, we will be forced to make greater investments than I have shown here.

Q. Have you prepared estimates in that direction?

A. I have sufficient information so that when I am confronted with one of these estimates of capacity requirements, I can very shortly furnish an estimate of the cost of providing the necessary capacity.

* * * * * * * * * *

[fol. 6095] Q. Mr. Burnham, in making your estimates as to the most economical method of adapting your lines to the required capacity, have you taken into consideration any alternative methods of supplying capacity?

A. We have, in the last year or two, given some consideration to developing underground storage and are at the moment engaged in activities which might result in the acquisition of underground storage eventually, but that is more or less an ephemeral sort of matter because underground storage is like oil, it is where we find it. You cannot build it, that is, you cannot build it in any huge [fol. 6096] quantities such as we would require to get any great benefit so if certain gas fields are later acquired by us, assuming they might be acquired, there is a possibility that underground storage might be utilized by this company to get the benefit for its customers.

Q. You have negotiations pending for the acquisition of underground storage, have you not?

A. I understand that we have.

Q. And in what fields do they relate?

A. I think those negotiations involve fields in Michigan.

Q. And what part of Michigan?

* * * * * * * * * *

[fol. 6097] The Witness: May I add something. We do know that, as a matter of supplying capacity, Exhibit 47 does reflect, in a positive manner, means by which capacity can be installed without any question about whether the proper kind of a storage field is developed or whether liquified storage can be developed to the extent—

Mr. Goodman: (Interposing) Now, Mr. Burnham—

The Witness: (Continuing) And at the figure that would result in a saving.

* * * * * * * * * *

[fol. 6098] By Mr. Goodman:

Q. Now, Mr. Burnham, you mentioned as an alternative means of securing capacity, liquefaction.

To what extent have you considered it?

A. We are following the development of the project at Cleveland, Ohio. That was the first plant ever built in the United States utilizing that principle.

Mr. Littman: That plant is owned by the East Ohio Gas Company, is it not?

The Witness: That is correct.

And should it develop that liquefaction is the answer to this storage problem and should we come to the conclusion that it may result in economies greater than, say, starting our third line, I believe that there is no question but what we may have recourse to liquified storage.

By Mr. Goodman:

Q. Do you have cost figures at your hands here as to the availability of liquefaction?

A. I do not.

Q. But it is something that you have in mind?

A. Yes, sir.

Q. And it looks to you as a distinct possibility worthy of being kept in mind?

A. I would not go as far as to say a distinct possibility. It is a possibility.

[fol. 6099] Q. At any rate, here is one concern which saw fit to liquefy gas in preference to putting in pipe line carrying capacity.

A. I do not know as to that because that same concern is now considering the building of a new pipe line into that area.

I would conclude that possibly their desire to build another pipe line into that area might be prompted by the fact that liquefied storage did not entirely solve their problems.

Q. I presume so, and they may need more capacity.

Mr. Littman: Pardon me for interrupting there, Mr. Goodman, but I should like to inquire from where to where is this proposed line expected to run?

The Witness: The information I have is only hearsay, but I understand it is to originate in the midcontinent, possibly in Louisiana and is to be built to some point in Ohio.

By Mr. Goodman:

Q. Well, you have in mind, Mr. Burnham, that liquefaction is not a means of a constant supply of gas. It is only a means of storing gas for future use, isn't that so?

A. That is so, and the same can be said of underground storage.

Q. Yes, but at the same time, though, while they may at times be used for the same purpose, that purpose coin- [fol. 6100] cides with the fact you were talking about meeting a peak demand, isn't that so?

A. That is correct.

Q. And with a pipe line, you also have the advantage of supplying a constant demand, is that right?

A. That is right.

Q. So that the building of a pipe line or contemplating a pipe line where there is a liquefying plant is pretty poor evidence of the efficiency of the liquefaction plant by itself, isn't it?

A. Well, it is all a matter of load factor. Quite naturally, if a load develops that would require a pipe line to operate in the order of 90 percent of its capacity or better at all times, there would be no gas available to be placed in storage.

However, if there is capacity at or during off-peak periods available for storage, either in the underground reservoirs or as liquefied gas, the application of storage in that event is possible.

Q. Yes. Now, another alternative is above-ground storage, is it not?

A. Yes, but that is very expensive.

Q. In other words, you are definitely of the opinion that the pipe line capacity is a cheaper means even of meeting [fol. 6101] peak loads than above-ground storage?

A. Yes, indeed, it is.

Q. And no doubt you have considered in that connection, the cost of above-ground storage?

A. We have.

Q. Do you review that occasionally?

A. It is not necessary, in such periods as this, with steel prices rising, to give a great deal of consideration to storage which requires so much steel as is required in the above-ground storage in gaseous form.

If steel should ever become extremely cheap, we might again examine the figures on above-ground storage.

Q. Does that exhaust the alternatives to pipe line capacity? Is there any other means that you know of that might be available?

A. We have been giving some consideration of late to the storage of gas in the solid form.

Q. That is merely an extension of the liquefaction process, isn't it?

A. It might be considered so. However, it is a different compound entirely. It is a hydrate of natural gas and if the information is true that we have, it might offer possibilities which would indicate it might be preferable to liquefied storage.

Q. And to what extent has your consideration of that [fol. 6102] subject gone?

A. We have only talked to the company which controls the research that is being made in this direction.

* * * * * * * *

[fol. 6103] Q. Mr. Burnham, you have stated a few moments ago that a new line was contemplated to be constructed for the service of Cleveland, Ohio, running from the gas fields in Louisiana over into Ohio.

Isn't it a fact that that line is proposed to be built by the Hope Natural Gas Company? Is that the line to which you refer?

A. It is very possible that is the line.

Q. And isn't it a fact that the terminus of that line [fol. 6104] will be in West Virginia?

A. Well, I inferred that it would go to Ohio markets.

Q. The gas would go to Ohio markets?

A. That is the reason I thought the terminus might be in Ohio.

Q. As a matter of fact, so far as you know, there are no new lines contemplated to be constructed by East Ohio

Gas Company from the Ohio River northward to Cleveland?

A. Not to my knowledge.

Q. Now, as I understand your testimony, this estimate which is set forth in your Exhibit No. 47 is simply an engineering job performed by you and your staff for the purpose of estimating the additions at Liberal station and eastward that would be required to meet the peak loads estimated by Witness Morton in Exhibit 40. Is that correct?

A. Yes, I believe that is a fair statement.

Q. You did not take any part in making any determination as to whether or not it would be economical to construct these capital additions in so far as the revenues to be derived from any new markets or new additional sales are concerned. Is that correct?

A. That is correct.

Q. In other words, to be a little more specific, when you determined, for instance, that it was necessary, in your opinion, to expend the sum of $6,684,100, for example, in [fol. 6105] 1944 for additions to main lines and additions to compressor stations in order to increase the 24-hour capacity of the system from 355,800 M.c.f. in 1943 to 380,-450 M.c.f., you were not making any determination that it would be economically sound and feasible and expedient to expend that sum of money in order to increase that capacity in so far as revenues were concerned, is that correct?

A. That is correct.

Q. In other words, you simply determined that this is the amount, as an engineer, you would advise your company that it would have to expend in order to meet this additional load, and that is all?

A. That is correct.

Q. And, of course, before Panhandle Eastern or any other company would expend such sums as are set forth in Exhibit 47, a determination as to the economic advisability and expediency will have to be made by the management itself?

* * * * * * * * * * * *

[fol. 6106] The Witness: I cannot agree with your conclusion. As I stated before, a natural gas company is duty bound to care for its customers.

In other words, it is devoted to the public service and if, by the expenditure of $6,684,100 in 1944, Panhandle Eastern Pipe Line Company could maintain good service on its system and if the money could be raised, there is no doubt in my mind but what the expenditure would be made.

As to the matter of whether it was economical or not, I presume that if a loss was incurred by making the expenditure, the Federal Power Commission could be appealed to and relief might be had from the Federal Power Commission in that event.

By Mr. Littman:

Q. Now, suppose the total increase is due to an ambitious reaching out program on the part of Panhandle [fol. 6107] Eastern in a search for entirely new markets. What would your answer be in that event?

A. Well, the instance that you have picked here for 1944 is not applicable in that case because this is merely main line additions to already connected markets.

Q. Well, a good part of it is new industrial business, isn't it? Of course, Mr. Morton's estimates show what it is.

Mr. Goodman: Maybe I can state this.

You have in mind, no doubt, that Michigan Consolidated Gas Company proposes to cut its peak demand by its acquiring facilities for underground storage and transmission of gas from the point of storage to Detroit.

If that project is completed and in operation, that will substantially modify Mr. Morton's figures of maximum day, will it not?

Mr. Culton: We think that again brings in a matter that is in the hands of the Power Commission at this time and is not related to a particular date.

The Michigan Consolidated Gas Company did not represent they would immediately have that. They recognized that it would be at least two years before they could possibly start the service.

Mr. Goodman: I simply addressed a question to the witness based upon future probabilities which is exactly what his testimony relates to and I asked him if it would

[fol. 6108] have any effect. I do not know whether it would or not.

Mr. Culton: His testimony has not related to future probabilities of that character. His testimony has assumed that these volumes would be required and he said, "Under those circumstances, here is what the capital expenditures would be."

Mr. Morton was examined on that question and Mr. Morton was the appropriate witness to be examined on that question.

This witness has not estimated the volumes required by the people at Detroit or any other purchaser.

Trial Examiner: I think we should try and keep away from the consideration of speculative alternatives except in so far as the witness admits they are under consideration as a part of the program of the Defendant company.

The witness has stated that consideration has been given to underground storage, to the liquefaction of gas for reserves and to the possibility of a chemical process resulting in solid gas for reserves.

Exhibit 47 is to support the inclusion in a rate base of future investments, in so far as it is shown in cross-examination that these investments are problematical, may or may not be made, the cross-examination, it seems to me, is decidedly of importance.

Mr. Wheat: May I add, Mr. Examiner, that at least one of the main purposes of Exhibit 47 is also to disclose that [fol. 6109] this company, this enterprise, must go to the money markets in the future in order to obtain the funds requisite for large additional capital expenditures.

Mr. Culton: Irrespective of whether any of it be included in the rate base.

Mr. Wheat: Yes.

Trial Examiner: The question occurs to the Trial Examiner whether any sums can be properly considered in the rate base which are not of a rather definite certainty.

Your inquiry into the field of a speculative future, it seems to me, is something that we cannot inquire too closely about because it is so clearly a speculative future.

I would like to have counsel express their views on this. I think we are in a rather difficult field.

Mr. Goodman: Well, I am frank to say, your Honor, that I think, in the first instance, we would be obliged to consider the total cost of rendering service for a reasonable period in the future inasmuch as the job of promulgating a rate is prospective in its application. The period must be reasonable and the cost must be shown by persuasive evidence.

Now, that I think is the entire question. Here is an exhibit presented which has only a hypothetical basis. The witness frankly admits that we have no plans afoot to make these expenditures but if we are to meet the estimates of another witness, this is what it is going to cost us.

[fol. 6110] Mr. Wheat: To what years do you refer now in that statement, Mr. Goodman? You certainly don't refer to 1941 or 1942, do you?

Mr. Goodman: I do not want to be cross-questioned on the thing. I think my statement, as I make it, is clear.

Mr. Wheat: I think we have got to be honest with ourselves, for the 1941 and 1942 expenditures are now being made.

Mr. Littman: Certain ones, I think you mean, Mr. Wheat, are now being made.

Trial Examiner: It seems to me we are entitled to a rather frank discussion of what period is involved. I think that is a matter of importance.

The matter was somewhat discussed in the Chicago case that was referred to early in the hearing as to just what future investments might be incorporated in the present rate base. It is clearly not in some remote, speculative future.

The Commission considered a 20-year claim for future investments which was outlined and discussed. The Commission, I believe, allowed, was it, Mr. Littman, 2½ years?

Mr. Culton: Three and one-half years.

Mr. Baldridge: Three and one-half years.

Trial Examiner: But that certainly is a definite factor to consider when we get into that remote period when there is no certainty concerning investments and Commission counsel or Complainants are certainly entitled to show it.

[fol. 6111] Mr. Culton: May I give just one sentence to express our position.

We think that unquestionably the investments which the evidence shows are of sufficient certainty to satisfy the Commission, that is, these investments that this witness has been discussing, should properly go into the rate base. They are immediate.

Now, these subsequent investments which are, to some extent, looking a little into the future and dependent upon certain increases, we do not contend they should go into the rate base as of now, but we do consider that we have a right to show the probability that we will expend those sums and what they will have to be spent for if the present indications are realized.

Trial Examiner: As bearing upon rate of return, a need for large sums of capital?

Mr. Culton: That is right, Mr. Examiner.

Mr. Littman: If your Honor please, I would like to respond to your Honor's request for a statement. I think the law is clear that only property presently used and useful may go into a rate base for rate-making purposes in the absence of any special circumstance.

Now, that is a general rule and I do not believe any special circumstances have been here shown that would warrant the inclusion of capital additions proposed to be [fol. 6112] made after the date as of which this Commission will speak. That is Point No. 1.

The second point I would like to make is that the evidence thus far discloses pretty much to my satisfaction, at least, that assuming for purposes of argument that all of these capital expenditures will be made in the future

as contemplated by Exhibit No. 47, in view of the increased sales as set forth by Mr. Morton in his Exhibit 40, and in view of the increased revenues which Mr. Morton has estimated will be derived from those sales it can be demonstrated and will be demonstrated that even if all of these capital additions were included in [in] a rate base extended theoretically into the future, that it would not justify any increase in rates arrived at without a consideration of those capital additions, increased the sales, and increased the revenues.

In other words, they would not have the effect of causing any upward revision in rates over those determined in the conventional manner.

Trial Examiner: It would not necessarily affect the rate which will constitute a fair return on the total capital.

Mr. Littman: That is what I am quite certain the evidence in this proceeding will show.

[fol. 6113] Now, moreover, I would like to make another point, and that is this:

When this Commission fixes a rate as of, let us say, today, we must, in looking into the future, consider not only if we are going to give future capital expenditures any consideration at all, we must also consider the depreciation that will accrue each year in the future and we must make proper allowance for that.

For example, if depreciation is accruing on the property of Panhandle Eastern in an amount of, let us say, just for purposes of example, $2,000,000 a year, why, of course, we must deduct that amount from the gross to secure the net additions.

I state that notwithstanding all of that, I am certain that the figures in the record thus far will show that the capital additions proposed by Exhibit 47, as well as the capital additions proposed by Mr. Hinton, would not have any adverse effect on the rate if Mr. Morton's estimate of sales and revenues is to be given consideration.

That states our position at this time.

Mr. Goodman: I would like to add a word on this subject as to how far in the future it is permissible to go. Under ideal conditions, that is, the conditions of perfect knowledge, I think it rather evident that that perfect knowledge would propound a unit cost for the total serv- [fol. 6114] ices of an enterprise which would be the lowest possible unit and it is because we do not have that perfect knowledge that we are compelled to limit how far we will enter into speculation.

Now, implicitly, we do give weight to the past and future of a business when, for example, we make an allocation as between an original value and remaining value.

For example, if we say that property has depreciated so much, we implicitly ascribe the proportion of depreciation to expired services and thereby apportion the remaining value to the services of the future. I mean this: That capital value differs only from annual expense in that the capital value is spread over more than one accounting period and the services expire in the course of what we may term a service life but that value with which we started, it is contemplated, will be ultimately used up in terms of annual expenses.

Now, one can never be correct or one can never make an approximation which itself is not an approximation having reference to the past and a simultaneous reference to the future. We think that we are saying the costs of the current year, but, in so far as those figures relate to or have reference to a cost which was incurred for services of several accounting periods, that is to say, capital costs, our thought is largely a delusion or, say, an inaccurate approximation.

Now, when we come to talk about the cost of service for the year 1942, we are compelled to make allocations [fol. 6115] which necessarily regard as much future as it is reasonable to contemplate, and I would say that they do necessarily regard total future and thus a depletion allowance, an allowance for depreciation of existing property necessarily contemplates the services of the future as distinguished from what has already transpired, so that I do not think that the formula as to what is included in

the rate base represents a hard and fast approach to the problem in every instance.

I would say that what Courts have done in applying the rate base standard is simply to pass upon the facts as presented by the parties. If a case lines up that way, the decision will line up in that way but, if one is able to show that our unit costs of service actually are thus and so, even though that involves consideration of future conditions, I see no reason why you should not be permitted to show that, for there is no desire to allow an unreasonable rate.

I would like to give a certain example of that Let us suppose that I have a machine which is capable of operating without any maintenance expense for a period of 8 years and, at the end of 8 years, it will require a pretty general overhauling and then will last for about two years more.

Now, isn't it clear that the money you are going to spend 8 years hence is part of the cost of today's service? It is to me.

Now, I admit that there may be disputes about that so I [fol. 6116] think that the actual latitude here is large. I am concerned with how adequate the evidence is. I do not think that there is any legal inhibition about searching the future in so far as it is reasonable, but I do think that the limitations are strictly those of a practicality. The one way of approaching the subject is to divide it up into periods or phases of exploitation. For example, one might say if the business is adapted to it, that we will consider the future to be like the present, a repetition of the present in so far as we are compelled to do so for purposes of depreciation or for purposes of getting at what we term present expenses and we will keep on considering it until certain events transpire, in which case, there enters into the picture what we may term a new phase of exploitation.

We keep on going then or we contemplate keeping on going until some further new phase of exploitation takes place.

Now, it may well be that that will turn out to be the most convenient approach to this particular problem. That

is, that we should approach it on the basis of an output comparable to 1941 or 1942 and compute all things as on a stabilized basis for that phase of the exploitation. Then when a thing fails of exploitation and large capital expenditures are required, then we admit we have not considered it.

Trial Examiner: I will be glad to hear from the other side of the room. It might help us to "keep on the beam."

[fol. 6117] Mr. Culton: I say "amen" to a great deal of what counsel has just said, Mr. Examiner.

I think the appropriate thing for us to do is to get all of the evidence on all of these phases the best way we can before the Commission and then, when the case is all over, we can approach this from all of the angles possible in determining what the correct answer is.

Unquestionably, all of this evidence is proper for consideration on at least two grounds. Then the weight to be given with respect to rate of return, with respect to rate base, can all be determined when the evidence has all been completed.

Mr. Littman: If your Honor please, I might amplify our position by stating if a company were operating at a 100 percent load factor, for example, and they had no additional markets and did not propose to acquire any or could not acquire any and if it were clear that they had to spend certain capital sums next year and the succeeding year in order to keep their business going and in order to deliver the same quantities of gas that they are now delivering, that is at the 100 percent load factor, then I presume the company would be in a position to demonstrate that its unit cost of service for the next two years will necessarily be increased, and I would say that under those circumstances, certainly the Commission might be very much interested in determining to what extent [fol. 6118] these increased capital additions will affect the cost of service. But here, we have not only capital additions, we have the evidence in the record, as shown by Exhibit 40, of great increases in sales, which I am certain can be demonstrated in this record more than offset the increases in costs occasioned by the capital additions.

To peer into the future, of course, is something that Commissions have been admonished to do in fixing a rate for the future in order that it may determine whether the rate it fixes today may not, in all probability, become confiscatory tomorrow.

* * * * * * * *

[fol. 6133] Mr. Littman: Let me ask you this, Mr. Burnham.

Assuming that your company is successful in its quest for underground storage, would that require you to revise your estimate shown in Exhibit 47?

The Witness: Certainly.

Mr. Littman: In other words, you would not require all of the pipe line capacity shown in Exhibit 47?

The Witness: No, but it might involve expenditures that might even offset entirely the expenditures we contemplate that might be required in pipe line and compressor station equipment.

* * * * * * * *

[fol. 6160] (Exhibit No. 47 was received in evidence.)

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[fol. 6163] Leith V. Watkins a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Cross-Examination.

By Mr. Gorman:

* * * * * * * *

[fol. 6171] Q. Mr. Watkins, will you turn your attention please to Exhibit No. 48? Now, commencing at the top of the first page of this exhibit, Mr. Watkins, line 3, account entitled "Other Investments", can you tell us what these investments represent? As I recall your direct testimony you stated that they were obligations of the Southwest Kansas Oil & Gas Company and the Saturn Oil & Gas Company which were due and payable to the Panhandle Eastern Company. Can you explain the nature of

the transactions which brought about this indebtedness ~~to the Respondent~~?

I am referring, of course, to the amount shown at June 30, 1941, in column "M", Mr. Watkins.

* * * * * * * *

[fol. 6172] The Witness: To try to summarize and save as much time as possible, Southwest Kansas Oil & Gas Company and the Saturn Oil & Gas Company were the owners at the time of the inception of Panhandle Eastern of some considerable amount of acreage in southwestern Kansas and may have had some producing wells at that time, with whom Panhandle Eastern entered into certain gas purchase and operating contracts for the exploitation of that acreage and the continuation of the right by Panhandle Eastern to purchase the gas produced from such acreage.

It may have been that the contract had certain drilling provisions in it.

Some time subsequent to the date of the original contract and June 30, 1941, the nature of those contracts was changed. The original contracts provided for Panhandle Eastern or it might have provided for Missouri Kansas Pipe Line Company to act as the operating manager and provided for the repayment to the operating manager of certain operating expenses and certain investment in both [fol. 6173] acreage and in the wells by the Southwest Kansas Oil & Gas and the Saturn Oil & Gas Company, the net result and sum of which was at June 30, 1941, there were balances due Panhandle Eastern on open accounts and notes, aggregating around $210,000.

Q. You mean less than the amount shown on page 1, Exhibit 48, line 3, column "M"?

A. The amount shown on line 3 in column "M" of Exhibit No. 48 is a consolidated figure. You will notice the exhibit is headed "Panhandle Eastern and Subsidiary Companies".

The indebtedness of Southwest Kansas Oil & Gas Company and the Saturn Oil & Gas Company is entirely indebtedness to Panhandle Eastern or the amounts that

make up the difference. If you wish the exact amounts due from those companies at June 30, I am prepared to give it.

Q. The other amount is rather inconsequential, amounting to about $4,000.

Now, is it correct that there is due on open accounts under this title the amount of $165,479.01 and that the balance represents notes payable?

A. Are we still talking about corporate balances or consolidated balances?

Q. Consolidated balances.

[fol. 6174] A. I will have to compute that if you wish it. I can give you the amount due on notes from a corporate standpoint.

Q. Well, I am speaking at the time of the manner in which you have set up this balance sheet, Exhibit No. 48, and the amount shown thereon.

A. Do you wish to take a recess while I compute it?

Q. No, you stated that the amount due from these two companies aggregated approximately $210,000, as I recall it. Is that correct?

A. That is correct and comprises both notes and open accounts.

Q. For the purposes of my questions, Mr. Watkins, suppose we do this: Assuming that there is approximately $165,000 due on open accounts, would that be by reason of the incurrence by the Panhandle Eastern Company of certain expenses in connection with the drilling of the wells which you have referred to previously?

A. If by "expenses" you mean actual operating expenses and construction cost—

* * * * * * * *

(Continuing)—the answer is yes.

* * * * * * * *

[fol. 6175] A. You will recall in response to a previous question the witness stated that at some time during the period from the inception of the original contracts and June 30, 1941, the contracts were changed. At that time, the unpaid balance was either represented by notes or the

open accounts took the form of notes. Those notes mature at specific intervals.

Q. Right there, ~~Mr. Watkins,~~ do you mean by that the entire amount was represented by notes?

A. The entire balance at the time the contracts were changed, if my memory is correct, was converted to notes.

The operating expenses charged to these companies by Panhandle Eastern and the amounts advanced for construction purposes subsequent to the conversion of the entire balance to notes is represented by the open account. The open account at June 30, 1941, is being amortized,—I should probably say paid, rather, over the life of the new contract, monthly payments being separated as to interest and principal, so that at the date upon which the contract naturally expires, the account will have been paid in full.

* * * * * * * *

[fol. 6176] Q. Commencing at page 862, line 17 there on that page you stated as follows, in speaking with reference to this account of "Other Investments" as it stood at June 30, 1941:—

* * * * * * * *

Q. (Continuing) "This amount represented on June 30, 1941, an amount due Panhandle Eastern Pipe Line Company by Southwest Kansas Oil & Gas Company and Saturn Oil & Gas Company on open account, amounting to [fol. 6177] $48,819.24. I beg your pardon. That represents four notes of equal amount dated January 6, 1936, of which one note is due each year during the years 1943 to 1946 and an open account due from the same companies amounting to $165,479.01."

Now, does that refresh your recollection, Mr. Watkins, the breakdown of this account of which we have been speaking?

A. It does and is the correct breakdown. Unfortunately, when testifying a moment ago as to those balances, I referred to a statement dated September 30, 1941.

Q. So that, if my addition is correct, the total of these two amounts, that is the amount due on notes and the amount due on open account, represents $214,298.25, which

is the total amount you have shown on this account at June 30, 1941. Is that correct?

A. That is correct.

Mr. Wheat: Mr. Gorman, as is shown on line 12 of page 862,

Mr. Gorman: Yes.

The Witness: And, also, as can be shown on line 3, column "M" of Exhibit 48.

* * * * * * * * *

Q. Can you tell us who owns or controls the Southwest [fol. 6178] Kansas and the Saturn Companies, Mr. Watkins?

A. Not specifically, no.

Q. Do you have any information on that subject?

A. My understanding is that these companies are now owned and controlled by some of the officers or directors or individuals, either directly associated with or indirectly with Michigan Consolidated Gas Company, some of its subsidiaries or parents.

Q. And there is no affiliation with the Panhandle Eastern Pipe Line Company insofar as you know?

A. Well, I should hope, sir, that we would have some direct neighborly affiliation with the Michigan Consolidated Gas Company confined in some of these accounts and some information, that is one of our largest customers and surely we must have some working affiliation.

Q. Well, of course, Mr. Watkins, I think you understand when I say "affiliation" I mean common control of ownership or through stock control or something of that nature.

A. There is nothing of that, as far as I know.

Q. Referring now to line 5 of page 1 of Exhibit No. 48, the account "Current Accrued Assets Representing Cash", will you tell us whether there has been any change in company policy in recent years in the handling and [fol. 6179] disposition of revenues?

A. I am afraid I don't understand that question.

Q. Well, I can explain it this way, then: Referring to this account I notice that from and after 1938, specifically during the years 1939 and 1940 and 1941, the com-

pany is carrying much larger cash balances than it had theretofore.

Does that represent any change in the policy of the company?

A. Not so far as I know and, as far as this witness knows, the fact that the balances at December 31, 1939, June 30, 1940, are larger than some prior dates is of no particular significance.

Q. Well, it indicates, does it not, that it was not in conformity with the practice of the company prior to 1939? In other words, they made some disposition of the cash received as revenues other than merely placing it in a cash account and holding it on hand?

A. Well, I shouldn't say that it indicated any change of policy, Mr. Gorman. There may be a set of circumstances or conditions present at these particular dates that explain why the balances are larger. Any organization such as ours must have funds with which to pay its bills, to do its construction work and carry on its business [fol. 6180] generally. It might have just so happened that at these particular times the funds shown by the amounts on line 5 in columns "K", "L" and "M" of Exhibit No. 48, were present and no particular need for them at that moment.

I don't attach any significance to it at all.

Q. Do you, in your official position, have any particular explanation for such large balances in those years?

A. Not at the moment, no. As a matter of fact, the explanation for any such balances would likely not rest with the comptroller. That is probably a question that should be directed to the treasurer.

Q. Yes, but you would have cause to believe that the secretary and comptroller are constantly in touch with the treasurer and Board of Directors and would have any familiarity with the decision of either which would necessitate the retention of such large cash balances, would you not?

A. I would likely have knowledge of it, yes, but having such knowledge I attach no special significance to it literally.

Q. Is it your testimony then that this is just a happenstance and has no relation to any direction of the president or the Board of Directors of your company?

A. I know of no direction of the president or the Board of Directors with respect to these three amounts that put [fol. 6181] them in any different category than the cash balances shown at the end of any other previous period shown by Exhibit No. 48.

Q. Do you know of any particular purpose for which any part of the cash balance shown at June 30, 1941, has been earmarked by the president or the Board of Directors?

A. Mr. Gorman, as my memory runs over the ten years that I have been connected with Panhandle Eastern Pipe Line Company, the Board of Directors have not necessarily earmarked any of dollars the company possessed. Earmarking dollars is a tremendously difficult problem. There may have been in the mind of the president or the treasurer the thought that the balances on hand at the dates we are discussing were to be ultimately used for construction or some other purpose.

If there was such a view in their minds you would have to ask them as to that.

Q. In other words, as I understand, you merely are charged with the responsibility of showing what was on hand in the way of cash during these years and have no responsibility whatsoever as to the disposition to be made of that cash.

A. Well, I would hardly go that far. As comptroller of Panhandle Eastern and its wholly-owned subsidiary, Illinois Natural Gas Company, I have, naturally, a decided in- [fol. 6182] terest in the input and output of cash.

I should not, myself, permit or within my knowledge permit any of my assistants to allow any disbursement to be made from the Company's funds that was not properly authorized. In the performance of the duties associated with my official capacity with the companies, I must, naturally, be responsible to some great extent to the collection of the amounts due it.

[fol. 6183] I have the responsibility of seeing that a proper record, along with the treasurer, is kept of all

matters pertaining to cash and, to that extent, I think, without belaboring the record here with a great deal more explanation of what such duties would be, I do have a decided interest and responsibility in connection with the cash of the company. As to trying to earmark it for this or to provide a certain amount for some particular purpose, that is within the scope of someone else's view.

Q. Well, summing up, then, and overlooking the repetition of this statement, is it correct that in so far as you know the amount of cash on hand at June 30, 1941, represents merely cash balances and in so far as you know was not being held for any particular purpose?

A. Well, it was being held for all the purposes for which is might be required, certainly.

Q. Yes, but I mean it was not being held for any particular construction that you were aware of, or for dividend purposes, or anything of that nature?

A. Well, I certainly do not know of it being held for dividend purposes. I am conscious of the fact that we have had a very large construction program in mind, and very naturally if such a construction program were carried out it would have to be paid for.

Q. Yes, of course, that would be the general opera-
[fol. 6184] tion, wouldn't it?

A. Surely.

Q. And that requires cash, of course, to meet your bills?

A. That is right.

Q. Turning now to line 6, the account designated as "Special Deposits," which is located in Column M of this Exhibit and June 30, 1941, it shows $1,489,127.23 which was an increase of approximately $1,480,000 over the balance remaining at December 31, 1940. Can you explain to us the reason for this considerable increase in this particular account?

A. The amount shown in Column "M" on line 6 of Exhibit No. 48—

Mr. Wheat: (Interposing) Page 1.

The Witness: Page 1 of Exhibit No. 48, represented in June 30 the amount of special deposits that Panhandle Eastern Pipe Line Company had made irrevocably with

either a trustee for the redemption of some bonds that had been previously called or special deposits of various natures with respect to service deposits for public utility service or right of way deposits in connection with the occupancy of certain properties, or deposits in connection with the guarantee of insured premiums, or deposits in connection with the payment of interest and the balance of [fol. 6185] $1,489,127.23 was largely made up of the amounts remaining in the hands of the corporate trustee for the redemption of the company's 4 per cent bonds called for redemption on or about April 1, 1940.

Have you any interest in the standing of the balance at September 30, 1941? It was materially reduced.

Q. Before we get to that, Mr. Watkins, do your papers set forth a breakdown of this amount which is shown at June 30, 1941?

A. No, I am sorry, I don't have such a breakdown.

Q. So that you don't know specifically what amount is represented as being held for the purpose of retiring this debt of which you just spoke?

A. No, but it was a large amount of the total shown at June 30, 1941.

Q. Can you indicate to us, Mr. Watkins, the source of this amount of approximately $1,480,000, which was placed in this account during the first six months of 1941? By the way, I, of course, don't mean revenues of the company, but I mean an indication of what account was credited with this amount when the charge was made to the special deposit account?

A. I believe you mentioned an amount somewhere in excess of $1,400,000.

Q. Well, I am speaking of the difference between the [fol. 6186] figure at December 31, 1940—

A. Actually there were several million dollars placed in the account on or about February 3, 1941. I don't have, at this moment, the exact amount, but it represented the principal amount of the four per cent bonds then outstanding and the accrued interest on them up to a certain date. The funds out of which such a deposit was irrevocably made with the corporate trustee came from the sale of other securities delivered at the same time the funds were deposited with the corporate trustee for the

redemption of the four per cent bonds called for retirement at that time.

Q. This account then at June 30, 1941, represented, as I understand, the balance remaining after certain refinancing operations were consummated during the month of February, 1941?

A. That, plus a small amount of deposits for other purposes, as the witness previously testified to.

Q. Yes. Now, you offered a moment ago, Mr. Watkins, to give us the balance remaining in this account, at September 30, 1941. Will you do so, please?

A. At September 30, 1941, the balance of the special deposits of Panhandle Eastern Pipe Line Company and subsidiary companies was $111,463.66.

Q. Does that indicate to you that there had been a certain amount of bonds or other indebtedness retired [fol. 6187] during the three months following June 30, 1941? A. It does.

Q. Referring now to line 13, page 1, of Exhibit No. 48, the account for "Materials and Supplies," can you tell us whether or not the amounts shown on December 31st of the several years indicated on this page fairly represented the amounts which the company was maintaining in its inventories during the months preceding and following December 31 of these years?

In other words, I will put it this way, does this account remain more or less static, excepting for periods of construction?

A. To an extent, yes. We have to think a bit about periods in answering that question. If you observe Exhibit No. 48 during the years 1930, 1931, and 1932, which was, so to speak, a part of our initial construction period, the Materials and Supplies account was the clearing ground, after a fashion, of the acquisition of materials intended for use for construction which was not delivered directly to construction jobs, so that subsequent to the year 1932, if you will recall, was the period in which the country generally began to feel the pinch of funds and the necessity for economies, conservation of cash, and so forth, quite acutely.

Our Materials and Supplies account began to slide down- [fol. 6188] ward, so that at the end of 1938, as shown by

line 13 in Column "G" or, rather, at the end of the year 1931, as shown by line 13 of Column "K", the balance had been reduced to slightly under $160,000.

Subsequent to that period, and during the entire period, the company felt that its policy with respect to materials and supplies was certainly on the conservative side and perhaps somewhat niggardly. We have never carried as much materials and supplies as we felt were actually needed. It has always been reasonably easy to get materials, and we didn't have, always, too much cash. We had constructions for which we needed our cash. We were growing rapidly. We didn't have as many compressor stations. Our load wasn't as much as it now is, and there were a variety of conditions that caused us to pinch as much as we possibly could with respect to our materials and supplies until the last few years we started somewhat in the other direction.

I believe there has been introduced in these proceedings quite a substantial amount of information with respect to material and supply requirements of the company as they now exist and may hereafter exist.

Q. Yes. Well, of course, we are now speaking of the conditions as they actually existed during the years shown on this exhibit.

A. I don't know whether I have answered your ques- [fol. 6189] tion or not, sir.

Q. Yes, you have, quite completely.

Is it the practice of the company that when materials or supplies are withdrawn from the warehouse to immediately place an order for the replacement of such articles as are withdrawn?

A. Well, Mr. Gorman, I don't know that I can answer that question as categorically and as fully as I should imagine you would like to have it answered. Off of the top of my head, I would say that, generally speaking, the company is constantly striving toward a certain level of basic materials and supplies needed for ordinary routine or for construction, and that it follows the practice of not being caught asleep when materials and supplies are needed.

Q. Yes. So that in so far as you know, it is the obvious policy of the company to attempt to maintain on hand such inventories as are necessary to enable it to maintain its business properly?

A. With the exception, as I have previously testified, in the period during which we were encountering the same business and economic conditions that confronted all other business enterprises, we couldn't always follow our inclination in that direction.

Q. Yes. You mean by reason of the lack of adequate funds you cut your inventories as much as it was possible [fol. 6190] to do so?

A. Not only that, there has been a time when the ability to obtain materials was much freer than it is at the moment or has been in the last few years. A wide variety of things governed exactly what we did or did not do with respect to our materials and supplies besides actual cash conditions.

Q. Yes. Well, of course, you did not at any time cut these inventories to a point below that which was necessary to maintain the system property, did you?

A. Well, Mr. Gorman, we have always preeminently in mind the requirement of an organization such as ours, regardless of what happens in other directions, to keep our properties in such condition that they can perform most satisfactorily from the standpoint of the customer.

There have been intervals over the ten years that I have been connected with the company that I have heard a good deal of griping from our operating departments and our construction forces that our materials and supplies were entirely inadequate. I do definitely know that over the period of my connection with Panhandle Eastern we have not had a sufficient amount of spare parts, for instance, at our compressor stations.

Not being an operating man, I can only tell you what I believe was responsible for such a condition. The man-[fol. 6191] agement, naturally, would not have permitted a situation of this sort to exist if it interfered with operating conditions, but we had at times a bit more capacity than we needed, perhaps, a bit more power than we actually needed, so that if we suffered a breakdown at some particular point we could pick up somewhere else and not

interfere with our ~~ability to~~ deliver or to meet our customers' requirements.

One couldn't just categorically put their finger on one particular thing in materials and supplies and say, "That is the reason we did this particular thing at that particular time."

Q. Yes. Well, to get back to my original question, Mr. Watkins, do you know of any instance where your inventories were too small to permit the company to adequately maintain its properties?

A. Personally, I do not.

Q. Mr. Sperry has testified in this proceeding, Mr. Watkins, that during recent months the company has undertaken to acquire a much greater inventory of materials and supplies and Mr. Sperry broke this down into different categories, one of which, I believe, was the materials and supplies actually on hand, secondly, were those which were on order, and thirdly, were those which the company anticipated ordering. Is that your understanding of that situation with respect to this account?

[fol. 6192] A. Well, I don't have any understanding whatever with respect to the account and Mr. Sperry's testimony that you speak of. I don't know that there is any direct connection between the account and his testimony. My understanding is that he did prepare and has introduced in these proceedings such information.

Q. Yes.

A. When the things concerning which he testified become actualities they will be interpreted by the account and not until then.

Q. But during the course of Mr. Sperry's testimony there was given the total which was in this account as of September 30, 1941. Can you give us the amount which was in this account at December 31, 1941?

A. At what?

Q. December 31.

A. No, I am sorry I don't have that. I could get it for you.

Q. Would you undertake to do so, please, and supply that for the record?

A. I may say, Mr. Gorman, that I don't know that our materials and supplies account is entirely closed for the year ended December 31. As you know, at the end of the year there is quite a considerable amount of work to be done to close the books of a corporation, and so forth, [fol. 6193] so that I might not be able to give you the actual final amount that will be shown per the books of December 31, 1941, but I will attempt to get it.

Q. Well, the answer which you would be able to give would very closely approximate the actual total, would it not?

A. I hope that will be the case.

Q. Yes.

In furnishing this information which I have requested, Mr. Watkins, could you break that down to show the amount of materials and supplies which are on hand due to the construction work which is presently in progress on your system and that which is now on hand to maintain the operating efficiency of the system as it now stands?

A. I am afraid not, Mr. Gorman, because generally this is the procedure that we follow: When materials and supplies are purchased directly for construction, they are forthwith charged to work orders covering such construction. We do not keep a balance of such amounts; as the construction work progresses, there is no reason to. If at the end of the construction period some of the materials are not used, they are then returned to the warehouse and the warehouse materials and supplies balance would reflect those amounts at that time.

I shall try to ascertain what were in the Materials [fol. 6194] and Supplies account at December 31, 1940, for construction purposes, and if the amount is significant we will give it to you, if we can obtain it.

Q. Well, do I understand correctly that the amount of materials on hand for construction purposes would have no relation to this account for materials and supplies, or would be charged directly, as you seem to indicate, by vouchers to Gas Plant account?

A. No, they are not charged to Gas Plant account. Perhaps if I restated it I could give you the picture a little more clearly.

Q. I might indicate to you, Mr. Watkins, my reasons for desiring an explanation of this item. You referred previously that during the years 1931 and 1932, when the company was engaged in a large construction program, that the large amounts shown for these items in those years was attributable in part to this construction. I am trying to find out whether that situation still obtains during the present time of construction.

A. There is a difference between the years 1930, 1931, and 1932, by the way. The witness wouldn't consider those amounts very large.

Q. They are large by comparison with the others?

A. Perhaps that is correct. The difference is this: In 1930, 1931 and 1932, there were materials purchased for con- [fol. 6195] struction, not in all cases used for construction for those particular periods, so that some of the materials and supplies balance in the years 1930, 1931, and 1932 represented the purchase of materials not actually used in construction in those years. That is the figure which I shall attempt to get for you at December 31, 1941, as being part of the materials and supplies.

Now, likewise, in the early construction period during the years 1930, 1931, and 1932, there were a great number of work orders and construction projects to which material was charged and which in our accounting procedure did not go through the warehouse at all. It was ordered specifically for and delivered directly to the job and never saw its way into the Materials and Supplies account.

Does that help you?

Q. Yes, it does.

Is it a correct statement to say that following construction and possibly during the period of construction that the amounts shown in the account for Materials and Supplies do not represent merely those items which have been ordered for maintenance and small extension work, but, also, represents left-overs, so to speak, of materials and supplies which were not used in the construction work, that is, the new construction work?

A. Yes, that is correct. I don't think our situation [fol. 6196] differs there from any other organization such as ours.

Q. Yes. Do you know whether or not the amounts which were shown in the balance sheet of September 30, 1941, for this account represented any items which had been returned or which had been charged, rather, to Materials and Supplies from construction work in progress?

A. Well, I am sure, Mr. Gorman, that at the end of any period shown by Exhibit No. 48 there were certain amounts in the Materials and Supplies account that had actually at some time been charged to construction work, because the very nature of the account would indicate that you just couldn't perform construction work and use up every specific piece of material that you purchase for it.

By the same token, you don't specifically purchase every piece of material or equipment for a construction job that is used on it. Some of it you withdraw from the warehouse. Furthermore, we have retirements in progress more or less all the time, and some of that material finds its way into the Materials and Supplies account, and to that extent we even have at all these periods some value or cost in the Materials and Supplies account that at one time or another was in Fixed Capital Gas Plant, as we call it under the Federal Power classification.

[fol. 6197] Q. Yes, so that it is a correct statement then to say that at no time and probably necessarily so, does the amount charged to this account represent only those items which are necessary to maintain the operating efficiency of the company?

A. Well, I don't believe I can agree with your statement, because the operating efficiency of the company does not, in my judgment, go entirely to the things necessary to turn the wheels day by day. There must be and should be a certain amount of materials available always to take care of unusual conditions as they arise, whatever their nature may be. We might have a river crossing that would go haywire on us or we might have some difficulty in a compressor station or there might be a great number of things that would involve the immediate use of materials to maintain our ability constantly to deliver the requirements of gas imposed upon us.

Q. Yes, well I think that more or less agrees with my statement too which I put the question. The primary purpose of this account, I think we will both agree, is for pro-

viding materials and supplies for maintenance and replacements, is it not?

A. I won't agree with that at all, sir.

Q. Well, with the exception of possibly small extensions, it does not undertake to provide materials and sup-
[fol. 6198] plies for the extensive construction, does it?

* * * * * * * *

The Witness: Well, I must frankly admit that my interpretation of the use of the materials and supplies account of Panhandle Eastern and its subsidiary companies, maintained as provided by the Federal Power classification of accounts, lends it to the customary and ordinary needs of the company with respect to their recordation of the debits and credits for the materials, the purchases, and uses in any manner whatever in its operations in the maintenance of its properties and the construction of its properties.

I don't know that I can narrow it down, Mr. Gorman, to the specific purpose more than that. I am not trying to confuse this thing.

* * * * * * * *

[fol. 6199] By Mr. Gorman:

Q. I assume, Mr. Watkins, that you are aware, as Mr. Sperry testified, that at the present time there is a considerable amount of unfilled orders for materials and supplies, are you not?

A. Yes, I am familiar with that condition.

Q. Are you familiar with the conditions which brought about the placement of these orders?

A. By that do you mean do I have knowledge of the construction authorized that gave rise to those orders?

Q. Yes.

A. Oh, surely, I know whenever any piece of construction is authorized—

Q. (Interposing) Well, of course, now maybe we are deviating a little bit, Mr. Watkins. I am speaking of those materials and supplies which are to be inventoried and placed in the warehouses.

A. I have some general knowledge of the things that
[fol. 6200] brought it about, yes, sir.

Q. But do you know whether or not the aggregate amount of these orders is affected in any degree by the long periods of delivery which the manufacturers are requiring at the present time?

A. Mr. Gorman, I think you had better direct your questions with respect to that to the witness who gave evidence in connection with it?

Now, let me say this: As to any difficulty that the company is experiencing with respect to delivery, I am not too familiar. I know, generally, that we are having trouble, just as one knows in general about a lot of things that are happening in an organization. The purchasing of materials, the following through to see that we get deliveries and payment for those materials, and so forth, is something that I run up against in the manner that you run up against things of that sort in the day-by-day operation of an organization such as ours. Specifically I don't keep very closely in touch with it.

Q. Does that mean, Mr. Watkins, that you have no information or knowledge as to this matter that I am speaking of now?

A. I wouldn't say exactly that. You couldn't ask me whether or not we had purchased an order for 14 automobiles and whether or not we had delivery of those, be- [fol. 6201] cause I wouldn't know. If you were to ask me whether or not we were generally getting decent deliveries with respect to such purchase, I could tell you yes or no. If you were to ask me whether or not all of the materials purchased for our present expansion construction program had been delivered, I could not answer you specifically, yes. I could tell you that I thought the deliveries were coming along satisfactorily or I probably would have heard somebody doing a considerable amount of growling concerning them.

Q. Does your knowledge permit you to say whether or not the placement of such a large amount of orders as this has apparently been customary, as indicated by the amounts shown on this exhibit, and is due in part to the fact that by the time that actual deliveries are made the present inventories will have been depleted to a considerable extent?

A. I don't have any opinion with respect to that other than that I am quite positive that Panhandle Eastern Pipe Line Company would not be ordering unnecessary materials.

Q. Well, I am not making any such accusation or suggestion. I am just trying to find out what your information and knowledge is as to this policy and what the present practice might be.

A. Well, I am frank to admit, sir, I don't know how I can answer you any differently than I have. I have [fol. 6202] stated that I am not charged with the responsibility of procuring materials and supplies. I do not follow the orders after they are placed. I don't know to what extent deliveries are being received, except in a general way. I do know very definitely that we, as an organization, watch our requirements so that there are sufficient materials when we need them for the requirement of our operations or construction. Now, if you are trying to elicit testimony from this witness with respect to Mr. Sperry's statements, you are going to have difficulty, because I had nothing to do with the preparation of his material, although I have a very definite belief that it is absolutely correct.

Q. Well, I am not trying to elicit information from this witness with respect to Mr. Sperry's testimony. I am trying to find out from this witness what is the arrangement with respect to this particular account. Now, do I understand correctly that you are not prepared to answer the question which I put to you a few moments ago?

A. I think I have answered it, sir. If I haven't, I have given the answer as far as I know that I can go.

* * * * * * * *

[fol. 6204] By Mr. Gorman:

Q. Turning your attention now, Mr. Watkins, to Lines 17 and 18 on Page 1 of this exhibit, which is the account for Unamortized Discount and Expense, can you tell us whether or not the Directors of the respondent company have recently made any decision as to the disposition to be made of the $2,101,985.62 which was in this account as of June 30, 1941, as indicated at Column M?

* * * * * * * *

A. At the meeting of the Board of Directors held December 19, 1941, the Directors of Panhandle Eastern authorized the charging of the balance in the accounts called Unamortized Debt Discount and Expense to Surplus after having credited to that account the saving resulting from the retirement of the funded debt in existence prior to February 3, 1941, and after restoring to ~~income~~ the amount of ~~amortization~~ taken on the unamortized balance subsequent to February 3, 1941, and after restoring to expense duplicate interest amount to $79,667.11, which had previously been charged to the Unamortized Debt Discount and Expense so that the general effect of such action was that the unamortized balance of the Debt Discount and Expense Account was charged to Surplus as of February 3, 1941—I mean effective as of February 3, 1941, and the call premium for redemption on February 3, 1941, which [fol. 6205] also was included in the debt discount and expense and the expense in connection with the issuance of the securities the proceeds from which were used to redeem the bonds outstanding prior to February, 1941, was likewise charged to surplus.

Q. Have the entries for these various charges which you have just enumerated, actually been made on the books of the company?

A. They are being made in the month of December.

* * * * * * * *

[fol. 6209] Q. Is the effect of these entries which you have just detailed such that it leaves, as of the present time, no remaining balance in this account for unamortized debt discount and expense?

[fol. 6210] A. That is correct. However, there are work orders in existence which, if our present proposed refinancing is consummated, may ultimately give rise to further amounts of unamortized debt discount and expense.

Q. Yes. Am I correct in understanding that that is the proposal which you now are seeking approval of by the Securities and Exchange Commission?

A. That is correct.

Q. I invite your attention now to Line 19 of this exhibit, which is the account for "Extraordinary Property Losses." Can you tell us, generally, what charges are made and what they represent in this account?

A. Generally, the balances shown on Line 19 as extraordinary property losses at December 31, 1932, '33, '34, '35 and '36 in Columns D, E, F, G and H, Page 41 of Exhibit No. 48, represent the cost of property retired by certain of the subsidiaries of Panhandle Eastern, since dissolved.

These charges arose as a result of the fact that at the time the properties were abandoned, there had not been sufficient reserves provided to absorb the charges.

The classification of accounts the company was following at that time permitted the charges of such amounts to an account titled, "Extraordinary Property Losses", subject to some subsequent distribution.

At the time the companies were dissolved, the amounts [fol. 6211] were charged to surplus or some liquidation account and the result of the charges as to Panhandle Eastern itself was reflected in any loss that it might have had to absorb at the time the subsidiaries were dissolved.

As far as my knowledge goes at the moment, I do not believe there were ever any amounts in this account and here we are speaking of a consolidated amount, that is, an amount representing Panhandle Eastern and subsidiary companies.

Q. Yes.

A. There was never any charge, as far as I know, in these amounts for property of Panhandle Eastern itself. I could be wrong there, but if you have any interest in the development of that fact, I will be very glad to give you a specific answer tomorrow. I think my answer, however, is correct.

Q. Well, may it be understood, Mr. Watkins, that you will make this check and if there is no reason for changing it, it will stand as correct?

A. That is quite all right, sir.

Q. Do the charges to this account, Mr. ~~Watkins~~, represent transfers from the plant account?

A. Generally, over the years, our practice with respect to retirement of property has been this: There may [fol. 6212] have been some slight variations here or there or refinements as we went along, but when the time arose for us to retire any property, we followed the practice of

the issuance of a retirement work order and immediately upon the issuance of a retirement work order, the amount at which the property to be retired was carried in the gas plant account, known by us as another amount at the time, was charged to suspense-retirement clearance.

When the retirement job had been completed, the original cost of the property retired plus the cost of retiring it less salvage recovered during the retirement was charged either to a reserve account or, if the reserve account was not sufficient, as was the case in the subsidiaries where the charges to extraordinary property losses arose, the charge was made to that account and later, as I previously testified, in liquidation the amount became a part of the loss, if there happened to be one, that Panhandle Eastern sustained in the disposition of the company or in connection with the dissolution.

I believe that the result of all of those amounts will be found in this witness' Exhibit No. 50 where it may be observed that certain charges have been made as a result of the dissolution of some of the companies that, at some previous time, had been a subsidiary of Panhandle Eastern.

Q. Is it correct to say, Mr. Watkins, that the primary [fol. 6213] purpose in transferring these items from the gas plant account to the account for extraordinary property losses was necessitated by reason of the fact that it was necessary to amortize these amounts in some manner different from that amortization or depreciation which was then provided for gas plant property?

A. I think that is correct. If I understand your question, it boils itself down simply to the fact that there were insufficient reserves, some disposition had to be made of the amounts, the classification of accounts used at that time provided the disposition by a charge to extraordinary property losses to be held pending some disposition and the disposition in cases of companies involved here was dissolution.

Q. Yes. Has the company had any similar instances which might be classified as extraordinary property losses since 1936 which have been disposed of in some manner other than that which you have just indicated?

A. One would have to have some definition, would they not, as to what would comprise an extraordinary loss, to answer specifically that question.

Maybe I can state the condition that I believe you are interested in in this fact: That any losses sustained by Panhandle Eastern or its subsidiaries subsequent, shall we say, to December 31, 1936, were not of the nature that there had not been reserves provided against which they [fol. 6214] could be charged.

Now, to characterize them as being extraordinary or not being extraordinary, I should think we would have to give weight to the particular loss, whatever it happened to be. Does that cover it?

Q. Yes, it does. Your answer indicates the thought that I had in mind, that is, that property losses presently are charged directly to the reserve for plant account without carrying them through some such account as this for extraordinary property losses.

A. That is correct and had the companies involved in these charges to extraordinary property losses had reserves sufficient, that same situation would have prevailed with respect to those companies.

Q. Will you please turn your attention to Line 22 of this exhibit, which is the account designated as "Other Work in Progress".

Can you explain to us the reason for the increase in this account from December 31, 1940, as shown in Column L when there was an amount of $2,975.91, to the amount remaining at June 30, 1941, as shown in Column M of $643,791.98?

A. I can, sir, and that is a very natural increase.

Q. Will you do so, please, that is, explain [illegible] for us?

A. The $643,791.98 balance shown on Line 22 in Column M on Page 1 of Exhibit 48 was made up of the following items:

[fol. 6215] Expenses in connection with the issue of first mortgage and first lien bonds, Series A, due serially, November 1, 1946, to November 1, 1950, inclusive; first mortgage and first lien 3 percent bonds, due November 1,

1960; and serial notes, Series A, B, C, and D, due serially November 1, 1942, to November 1, 1945, inclusive;

Call premium on first mortgage and first lien bonds, Series A, 4 percent, due March 1, 1952;—$420,040.

Expense of new issues (since January 1, 1941)—$244,074.03.

Making a total of—$664,114.03.

Less estimated amortization recorded as of June 30, 1941—$24,585.61

Leaving a balance of—$639,528.42.

Work in progress—chargeable to Others—$1,242.18.

Preliminary expense—proposed construction projects —$2,471.75.

Electrical protection tests on lines and other minor items—$549.63.

The expenses in connection with the securities amounting to—$639,528.42 were cleared from the account "Other work in progress" in the month of October by a charge to unamortized debt discount and expense, and in the month of December, as this witness has previously testified, disappeared from the company's records altogether by a charge to surplus.

[fol. 6216] Does that give you the information?

Q. Yes, it does.

Now, will you please turn to Page 2 of this exhibit. In your direct testimony, Mr. Watkins, you stated on page 894 with reference to the account shown at Line 2, Page 2, of Exhibit No. 48 as representing the account titled, "Common Capital Stock", that an amount of $15,017,300 was transferred from capital surplus to common stock.

~~Can you tell us what part of this amount, so transferred,~~ represented cash?

A. I cannot.

Q. Do you know whether any part of it represented cash?

A. I am quite positive that a substantial amount of it represented cash.

Q. Do you know whether or not a part of it represented property?

A. Are we talking about representing cash or property of Panhandle Eastern or to some other organization?

Q. Well, since this is a consolidated balance sheet of the Panhandle Eastern Pipe Line Company and subsidiary companies, as the title indicates, I think we must necessarily talk about a consolidated item.

A. Maybe I do not ask the question correct, Mr. Gorman.

If you will refer to Exhibit 51, you will observe that on Lines 3, 4 and 5 there appears an amount of $19,335,867.47 [fol. 6217] in Column B. Without reading the testimony that I have previously given in connection with this amount of 19 million-odd dollars, I believe my statements with respect to the $15,017,300 which likewise is shown in Exhibit 51 on Lines 39 and 40 in Column H, referred to the fact that the $15,017,300 was a part of the capital surplus or $19,335,867.47 appearing on Lines 3, 4 and 5 of Page 1 of Exhibit 51.

The $19,335,867.47 became capital surplus on the part of Panhandle Eastern as a result of the donation to it of certain assets, funds and indebtedness canceled by Missouri-Kansas Pipe Line Company as of August 31, 1930.

This witness has had no access to the books and records of Missouri-Kansas Pipe Line Company, but, in the disposition of the $19,000,000-odd dollars donated to Panhandle Eastern by Missouri-Kansas Pipe Line Company as of August 31, 1930, and the many ways in which, during the course of the ten years I have been connected with the operation of the books and accounts of these companies, I am very definitely of the opinion that a great portion of the $19,335,867.47 represented cash originally invested by some organization in properties.

Now, at the time the entries with respect to this amount were recorded on the books of Panhandle Eastern certain of the properties received by Panhandle Eastern were owned by subsidiaries, since dissolved.

[fol. 6218] However, most of such properties remain a part and parcel of the general properties and facilities

owned by Panhandle Eastern. Some of the $19,000,000 represented indebtedness of Panhandle Eastern to Missouri-Kansas Pipe Line Company as a result of advances made by Missouri-Kansas Pipe Line Company to Panhandle Eastern; either secured by notes or on open account for construction purposes.

They represented, likewise, advances made to certain companies which became subsidiaries of Panhandle Eastern as a result of the donation on August 31, 1930, by Missouri-Kansas Pipe Line Company and that indebtedness to Missouri-Kansas Pipe Line Company likewise represented amounts due it from these subsidiaries, either on open account or notes, for funds advanced to the subsidiaries and actually used by them in construction purposes and further represented the amounts invested by Missouri-Kansas Pipe Line Company in certain other subsidiaries and in the company's so-called Local Area System.

I believe, sir, without trying to say categorically that I have definite knowledge that each of the dollars represented by the $19,335,867.47 were actually invested in property, it is quite proper and logical to state that my knowledge of the amounts is such that I can have no hesitancy in saying that the greater part of it actually was invested in properties.

Q. But was this acquisition of assets of properties and [fol. 6219] other items from the Missouri-Kansas Pipe Line Company brought about through an agreement which was made between the Missouri-Kansas Pipe Line Company, the Columbia Oil and Gasoline Corporation and the National City Company as of September 17, 1930?

A. That is correct, together with certain amendments made within the next month or so thereafter.

Q. And was this amount of $19,335,867.47 set up for the purpose of determining how much the Columbia Company would provide to continue the construction program undertaken by the Panhandle Eastern Company at that time?

A. No, not as far as I know.

Q. What is your understanding of it?

A. The agreement of which you spoke dated September 17, 1930, as amended in October, 1930, perhaps Oc-

tober 23, and actually consummated along about that time, provided the amount of assets, properties and so forth to be donated to Panhandle Eastern by Missouri-Kansas Pipe Line Company.

Q. Are you quite sure of that statement, Mr. Watkins, or did it not provide the manner in which such calculations should be made?

A. That is correct. Generally speaking, the effect was to provide it.

Q. But it did not specifically state any amount whatsoever except I believe there were certain figures given [fol. 6220] with reference to the so-called Local Area properties, is that correct?

A. Well, I do not really know just exactly what figures were given in the September 17 contract without referring to it except that it is my remembrance that the contract was the basis upon which the donations, concerning which we have been discussing here in the last few minutes, came into the possession of Panhandle Eastern.

Q. It also follows, does it not, that this amount of $19,000,000-odd of which we have been speaking, was a calculation resulting from the terms and conditions of that agreement of September 17 which provided for the transfer of these properties to the Panhandle Company?

A. So far as Panhandle Eastern is concerned, the $19,000,000 concerning which we have been speaking is the amount at which the assets, properties, cancelation of indebtedness and so forth were recorded on its books.

I do not hardly know how to characterize your observation with respect to "calculation."

My memory goes that the September 17, 1930, contract, as modified, did provide the machinery by which certain amounts would be determined. Now, so far as Panhandle Eastern is concerned, it was the recipient of certain assets which were recorded on its books on the basis of the best information available to it.

[fol. 6221] Q. Have you ever made an investigation to determine what portion of this $19,335,867.47 actually represented the value of property or what amounts actually represented cash transferred?

A. Well, I believe I can be helpful in that respect, perhaps, if you will bear a moment or so with me.

Q. If you will, please.

A. It appears from an analysis the witness has before him of the paid in capital and surplus of Panhandle Eastern Pipe Line Company as of September 1, 1930, that the capital stock of the Company at August 31, 1930, was carried on its books at $50,000;

That there were acquired from Missouri-Kansas Pipe Line Company, without cost to Panhandle Eastern Pipe Line Company, the following assets:

Property, plant and equipment (Local Field),	$ 2,197,475.40
Purchase and sales contracts (Local Field),	$ 2,398,402.19
Construction work in progress (Local Field),	$ 220,473.12
Investment in associated companies:	
Missouri-Kansas Gas Company,	$ 627,661.22
Central States Gas Utilities Company,	$ 112,420.74
[fol. 6222] J. D. Judd & Company (51%)	$ 35,266.72
Shale Gas Corporation (51%)	$ 164,902.37
General Supplies,	$ 46,140.41
Inter-Company Accounts represented—	
Notes Receivable from—	
J. D. Judd & Company,	$ 57,500.00
Accounts Receivable represented by accounts receivable from—	
Central States Gas Utilities Co., amounting to	$ 16,094.21
Missouri-Kansas Gas Co.,	$ 392,564.75
J. D. Judd & Co.,	$ 10,354.93
Prepaid Accounts amounting to	$ 3,565.19
Less Deferred Liabilities, Jacksonville Property,	$ 18,569.56
And Less Accrued Taxes,	$ 14,066.06
Those items make a total of	$ 6,250,185.63

Missouri-Kansas Pipe Line Company canceled the following Inter-company accounts on the books of Panhandle Eastern Pipe Line Company:

Notes Payable to Missouri-Kansas Pipe Line Company by Panhandle Eastern,	$ 1,990,975.00
Accounts Payable by Panhandle Eastern to Missouri-Kansas Pipe Line Company,	$ 4,377,407.16
Accounts Payable by Panhandle Eastern [fol. 6223] to Texas Interstate Pipe Line Company,	$ 245,613.18
Less a credit represented by interest during construction,	$ 7,617.38
Making a total of,	$ 6,606,377.96

Missouri-Kansas Pipe Line Company made a payment to Panhandle Eastern to liquidate the current indebtedness of Panhandle Eastern, Panhandle Illinois Pipe Line Company and Texas Interstate Pipe Line Company obligations shown in purchase price, $ 6,479,303.88

All of which items aggregate, $19,385,867.47

Q. Was that 385,000 or 335,000?

A. 385,000, sir, because, if you will recall, the analysis covered both paid in capital and surplus.

Q. Yes.

Do I understand from your answer, Mr. Watkins, that this analysis which you have just given showed by detailed accounts and amounts the charges which were made on the books of the Panhandle Eastern Pipe Line Company at the time of these acquisitions from Mo-Kan Company?

A. I think that is substantially correct. There may have been some slight deviation in the accounts when recording the amounts on the books of Panhandle Eastern.

Counsel for the Commission might be interested in the table shown on Page 17 of a report on the accounts and records of Panhandle Eastern Pipe Line Company as a [fol. 6224] result of an examination made by the Federal Trade Commission, copies of which I am quite positive would be available to the Power Commission.

This table gives a comparison of the amounts at which the donated assets just described were carried on the books of Missouri-Kansas Pipe Line Company and later recorded on the books of Panhandle Eastern Pipe Line Company.

* * * * * * * * *

[fol. 6242] By Mr. Gorman:

Q. Mr. Watkins, at the time of taking the luncheon recess, we were discussing the amounts which had been set up on the books of Panhandle Eastern Pipe Line Company as representing assets and other items acquired from the Missouri-Kansas Pipe Line Company in 1930. I don't recall

[fol. 6243] whether I asked the question. If I did, I would like to have the answer repeated now, and that is whether or not the figures which you read as representing the value of these properties represents the extent of your knowledge as to the cost of various items transferred to the Panhandle Eastern Company.

A. I believe you did ask that question and my remembrance is that the witness replied that his knowledge with respect to these amounts began with the time when they were donated to Panhandle Eastern, and that we had no direct knowledge of the amount at which any of them were carried on the books of Missouri-Kansas Pipe Line Company, or any other company that may have theretofore owned them.

* * * * * * * *

[fol. 6245] By Mr. Gorman:

Q. Now, referring, again, to the reference which I made previously to the original Registration Statement as filed on December 24, 1941, there appears the following note attached to the balance sheet and made an integral part of such balance sheet of the Panhandle Eastern Pipe Line Company:

> "Property plant and equipment is stated at cost except for $2,417,948.52 thereof assigned by the Board of Directors to assets acquired as of August 31, 1930, as a capital contribution."

Now, that, as I understand, Mr. Watkins, relates to this property which was acquired from the Missouri-Kansas Company, does it not?

A. It relates to a portion of such property and states the amount thereof as of September 30, 1930. A good deal of this property represented by the $2,417,948.52 has since been retired and some of it replaced.

Q. Now, can you explain to us the significance of the statement that the property plant and equipment is stated at cost except for this $2,000,000-odd?

A. I can.

Q. Will you do so, please?

A. We have had a great deal of testimony today about certain assets, obligations, and so forth donated to Pan-[fol. 6246] handle Eastern by Mo.-Kan.

Mr. Culton: By "Mo-Kan" you mean Missouri-Kansas Pipe Line Company?

The Witness: That is correct. It was my understanding that in the proceedings Panhandle Eastern Pipe Line Company and Missouri-Kansas Pipe Line Company have been referred to as Panhandle Eastern, and as Mo-Kan, and if I may be permitted to do so I shall follow that procedure.

(Continuing) Included in the amount of this donation or, rather, included in this donation was certain property plant and equipment consisting of Organization amounting to $10,018.14; Miscellaneous Intangible Capital amounting to $25,192.17; Land, amounting to $1,940.75; Measuring Station Buildings, amounting to $9,793.95; Other Transmission System Buildings, amounting to $4,750.48; Meters and Gauges, amounting to $52,035.48; Compressor Station Equipment, amounting to $270,534.33; Field Lines, amounting to $214,324.74; Transmission Lines, amounting to $1,494,487.79; Furniture and Fixtures, amounting to $41,728.81; Automobiles and trucks, amounting to $65,459.-17; Shop Equipment, amounting to $3,867.22; Laboratory and Engineering Department, amounting to $2,509.77; Other General Equipment, amounting to $832.60; Construction Work in Progress, amounting to $220,473.12.

These amounts make up the total shown opposite the [fol. 6247] caption "Property, Plant and Equipment" on page 17 of the Federal Trade Commission report by Mr. M. C. Steele, referred to in the testimony of the morning session, and the amount of construction work in progress shown thereon.

Mr. Wheat: May I ask, Mr. Watkins, under what general heading is that shown in Mr. Steele's report?

Mr. Gorman: This is identified, is it not, as Table 2?

The Witness: That is correct, it is so identified.

I believe I have with me, although I am not able to find the Table readily, a statement which will show the changes in the $2,417,000-odd figure since September 30, 1930. A great deal of the property represented by the charges to the accounts which the witness stated in the record a

moment or so ago has been retired and portions have been replaced and additional property has been constructed, so that out of the $2,400,000-odd we still have a residue of the amount represented at September 30, 1930, as property received by Panhandle Eastern, Organization, Miscellaneous Intangible Capital, and so forth, as shown by the detail previously stated.

* * * * * * * *

[fol. 6248] A. The reason for the statement to which you refer in the Registration Statement is a well recognized requirement of independent public accountants and reports made as a result of their investigations and was followed by the public accounting profession quite a while in advance of the advent of the Natural Gas Act or the Securities and Exchange Act of 1934, or the Act of 1933.

However, there are manifestations in the requirements of certain forms to be filed under those Acts, that the basis upon which properties are carried on the books of an organization should be stated in accounting certificates or notes with respect to accounting reports and I verily believe, sir, that if we do not make some such statement in any Registration Statement filed with the Securities and Exchange Commission we would immediately get a deficiency.

Q. Well, in that connection, Mr. Watkins, I note at page S-1 of this Registration Statement, to which we have been making reference, there appears the Auditor's Certificate of Arthur Andersen & Company. Do I understand from the testimony which you just gave that that note [fol. 6249] which we have read from the statement was inserted at the request and insistence of the auditor?

A. And you should deduct, sir, the accounting information included in the Registration Statement which is covered entirely by the accountant's certificate to which you have just made reference.

Q. That is correct.

A. The financial information included in the Registration Statement is certified to entirely by Arthur Andersen & Company with respect to Panhandle Eastern and the matters covered by their work, and with respect to Michigan Gas Transmission Corporation and Indiana Gas Dis-

tribution Corporation the matter is certified to by Messrs. Price, Waterhouse & Company with respect to the matters covered by their work.

I don't believe you meant to infer that the company suggested to Messrs. Arthur Andersen & Company or the other firm of public accountants what those organizations should put in the balance sheet or in the Registration Statement as their comments?

Q. No, I merely intended to indicate, without any harmful intention whatsoever, that the certification of the auditors of that balance sheet was qualified to the extent indicated in the notes attached to that balance sheet. Was that the correct assumption?
[fol. 6250] A. Oh, I think it has to be, sir.

* * * * * * * *

[fol. 6254] By Mr. Gorman:
Q. Mr. Watkins, at the time of the recess, you were to undertake to find certain notes which would explain certain matters in connection with the amount of $2,417,948.52 to which we have previously made reference.

Were you able to locate those notes?

A. Yes, I was, and the particular reason I wanted to locate the notes was because of the fact, that I felt that there might be some question in someone's mind that this $2,417,948.52 received by Panhandle Eastern as a part of the total of $19,300,000-odd donated by Mo-Kan did not represent actual cost and, by the introduction of the total amount of retirements made out of the $2,417,948.52 from August 31, 1930, to September 30, 1941, [fol. 6255] a portion of that question, if there be any, would be dispelled from anyone's mind.

The retirements of property represented by the $2,417,948.52 from August 31, 1930, to September 30, 1941, amounted to $1,034,043.54.

During that same period, there was subsequent additions made having a cost of $534,243.91.

Q. What was that figure again? A. $534,243.91.
Q. Thank you.

A. So that the balance represented by the original amount, $2,417,948.52 less subsequent retirements plus subsequent additions was $1,918,148.89 at September 30, 1941.

Q. From this statement, Mr. Watkins, is it correct to say that as of September 30, 1941, there remained of the property acquired from the Missouri-Kansas Company, which is related to this statement which we have quoted, $2,417,948.52, less retirements of $1,034,043.54, is that correct?

A. I am afraid, Mr. Gorman, we could not quite say that properly because some portion of the retirements amounting to $1,034,043.54 may have represented retirements of a portion of the subsequent additions amounting to $534,243.91.

I do not actually have with me a segregation of the retirements as to the amount originally received from Missouri-Kansas represented by the $2,400,000-odd and as [fol. 6256] applicable to the $534,000 item comprising the subsequent additions.

Q. Do your notes indicate the period during which these additions comprising the total of $534,000-odd were made?

A. Yes, they do, and I believe I have stated that they were made between August 31, 1930, and September 30, 1941.

Q. Would it be your opinion that in all likelihood there would have been only a very small amount of this $534,000 retired up to September 30, 1941, by reason of the newness of this property?

A. If I express such an opinion, I would have to give consideration to the fact that the properties originally represented by $2,400,000 were what has been characterized in these proceedings as the Local Area properties in which there is a considerable turnover in investment by reason of the diminution of supply, the movement of gathering lines, field lines and measuring stations, and I am afraid it would be improper for me to hazard a guess.

Q. Your reference to the Local Area properties is predicated upon the fact that it is anticipated that the reserves of gas in the Local Area will be exhausted within the next few years, is it not?

A. No, sir. My statement with respect to the rapidity of turnover in investment in the Local Area is because [fol. 6257] there have been certain producing properties which, since August 31, 1930, have become non-producing properties. The wells in this Local Area are shallow wells, the gas reserves under them are not great.

There is a great deal of drilling and a great deal of recovery of materials in the property, movement from one place to another within the Local Area field, not so much crystal gazing as to what might happen to the reserves in the future.

My statement is predicated entirely upon what I know has happened in the past. I would be afraid to state that only a small portion of the $534,000 figure had been retired.

I would want to be as realistic as one possibly can about the matter and I cannot conscientiously make such a statement.

Q. Well, to accurately and definitely determine that would require an analysis of each retirement which has been made from August 31, 1930, through September 30, 1941, of the property originally donated by Mo-Kan?

A. That is true and which I certainly hope you will not ask us to prepare.

Q. No, I understand. Do you have no accounts from which this amount could be easily and readily ascertained?

A. As to the investment as it existed at August 31, 1930, and as to the subsequent additions, we do not have [fol. 6258] any records from which a segregation could readily be made of the amount of retirements during that period applicable to those two classes of investment.

Q. And you are, therefore, not in a position at the present time to indicate specifically what portion of this amount of $2,417,000 which has been included in your gas plant account was donated by the Mo-Kan Company?

A. Yes. I have specifically testified during the proceedings today that the whole of the $2,417,948.52 was among the assets donated by Mo-Kan.

Q. I was speaking—

A. (Interposing) As to the retirements, no.

Q. I was speaking as of the amount remaining at the present time.

A. No, I could not segregate that.

Q. You understand, of course, I am speaking of the gas plant account as it stood at June 30, 1941?

A. With respect to this particular item only?

Q. Yes, that is right.

A. Yes.

Q. Mr. Watkins, all of this discussion which we have been recently engaged in concerned only $15,017,300 of the total shown in Column M of Line 2 of Page 2 of Exhibit No. 48 which, at June 30, 1941, was $20,184,175, the difference being, according to my calculations, $5,166,875.

[fol. 6259] Can you tell us what portion of this valuation of common capital stock represents property and cash?

A. I am afraid you have me confused, sir.

We have recently been talking about $19,300,000-odd that came into the proceedings as a result of the question previously predicated and you are now asking about the $15,017,300, is that correct?

Q. That is correct.

A. Now, we are going back to the $15,000,000-odd figure that is in the capital account, is that right?

Q. No, to the difference between the $15,017,300 and the $20,184,175, which was present in this account as of June 30, 1941. Do you understand my question now?

A. Yes, I believe I have your question in mind correctly.

If I may give you the general substance of what happened without testifying with respect to specific amounts, I believe it would speed things along and perhaps reach the conclusion that you have in mind.

If you will observe Page 2 of Exhibit No. 48, you will observe that at December 31, 1930, the common capital stock is stated on Line 2 of Column B at $100,000. If we may begin there and proceed toward the $20,184,175, will that be satisfactory?

Q. I am sure that will be.

[fol. 6260] A. At or about October, 1930, a contract was entered into between Columbia Oil and Gasoline Corporation, Missouri-Kansas Pipe Line Company and, I believe, the Chase National Bank—

Q. (Interposing) I believe it was the National City?

A. This, I believe, was the Chase National Bank, providing the medium through which some $10,900,000, I believe, would be available to Panhandle Eastern Pipe Line Company to complete the construction program under which, at the time, Columbia Oil and Gasoline Corporation acquired one-half of the outstanding stock of Panhandle Eastern from Missouri-Kansas Pipe Line Company.

Without indulging in too much explanation as to the nature of that contract, it provided that by the submission by Panhandle Eastern of certain construction certificates, there would be made available to it 100 percent of the amount of such construction certificates out of funds provided by Columbia Oil and Gasoline Corporation and Missouri-Kansas Pipe Line Company.

Now, when the witness refers in this respect to Missouri-Kansas Pipe Line Company, he is stepping through several corporate walls because, actually, there was another corporation interposed that provided the funds, but the effect was they came from Mo-Kan.

Q. You are speaking of the Panhandle Corporation?

[fol. 6261] A. That is correct, and the funds made available to Panhandle Eastern for construction purposes were to be represented by notes and common stock in the proportion of $90 of notes and two shares of common stock to each $100 of construction.

You will observe the common capital stock account increased up to a total, in 1935, of $1,199,000 as shown in Column G on Line 2 of Page 2 of Exhibit No. 48.

That increase was the result of the issuance of stock as a part of Panhandle Eastern's obligation to the two companies under this three-part contract through which the additional construction funds were provided.

Q. Was that for cash received?

A. Entirely for cash received. As I have stated, Panhandle Eastern was required, under this contract, to sub-

mit to the Chase National Bank, I believe, certain specific construction certificates and there was some legal procedure followed by the bank or its nominee to acquire the funds from Columbia Oil and Mo-Kan upon the receipt of which Panhandle Eastern gave its notes and stock certificates.

The increase beginning in 1936 came about from two directions. My memory runs to the fact that in March, perhaps March 24, 1936, Panhandle Eastern issued the right to its stockholders, there being only two at that time, to subscribe to 160,000 shares at $25 a share.

[fol. 6262] One of the two stockholders subscribed to its 80,000 shares on April 1, 1936, which increased the common capitalization by $2,000,000.

Then, as shown by Exhibit 51, there was transferred from capital surplus to the common stock account an amount of $15,017,300 as a result of action by Panhandle Eastern Pipe Line Company's Board of Directors.

These transactions increased the common capital stock to $18,216,300, as shown on Line 2 in Columns H, I and J of Page 2 of Exhibit 48.

In 1939, the 80,000 shares warrant, which had been issued to the second stockholder in 1936 and held subsequent to that time by that stockholder's receivers, was offered to the stockholders of that organization and all but 1,285 shares of the 80,000 shares were subscribed by such stockholders on or before October 29, 1939.

This increased the balance in the common capital stock account, as shown on Page 2, Line 2, Column K, to $20,184,175, which amount remained unchanged to June 30, 1941 and, for that matter, to January 20, 1942.

Q. Does that complete your answer, Mr. Watkins?
A. If it answers your question, it does.
Q. Yes, it does. Can you tell us, Mr. Watkins, to the best of your recollection how many shares of common stock were outstanding at December 31, 1935, as represented [fol. 6263] by the amount shown in Column G, Line 2, of this exhibit?
A. I believe there were 2,298.

Q. Referring to Page 1 of Exhibit No. 51, Lines 39 and 40 bear the following statement, "Capital surplus assigned to stock dividend paid by the issuance of 646,354 shares of common stock" which, according to Column H for the year 1936, represented the amount of $15,017,300 of which we have been speaking.

Therefore, the common stock outstanding was increased as of that year to the extent of 646,354 shares, was it not?

A. That is correct.

Q. Will you explain to us the circumstances, that is, explain somewhat briefly the circumstances which brought about the issuance of this stock?

A. I am not sure that it was entirely a result of the agreement entered into in October 1930, between Panhandle Eastern, Mo-Kan and the Chase National Bank or as a result of some other corporate action that the stock of Panhandle Eastern was represented in the hands of the stockholders by voting trust certificates.

In 1935, I believe at July 31, the voting trust was dissolved and either coincident with the dissolution of the voting trust or the common stock or perhaps slightly prior thereto, the number of shares of common stock was reduced from 229,800 such shares to 2298 of such shares.

[fol. 6264] The latter number of shares remained unchanged until the stock dividend referred to in Lines 39 and 40 of Exhibit No. 51 was paid.

The Board's action was, I believe in conformity with the general corporate laws of the State of Delaware, that the price at which the 648,354 shares paid as a stock dividend was deemed to have been issued was $25 a share and by a simple arithmetic calculation, we arrived at the $15,017,300.

Does that answer your question, sir?

Q. Yes, excepting for another thought which I have in mind.

Was the issuance of this stock related in any way whatsoever to the settlement of a suit which had been instituted by the stockholders or receivers for the Missouri-Kansas Pipe Line Company against certain individuals claiming,

I believe, some $180,000,000 in damages? You had better answer that phase of the question first.

A. I doubt that it had too close a connection to that. There might have been some connection. Frankly, I do not know. There was a recapitulation of Panhandle Eastern Pipe Line Company under way at the time. There were a great many corporate matters being disposed of.

The fact that the corporation had 2,298 shares was a terrific amount in its capital account and was a bit awkward and that perhaps gave rise to some additional taxes [fol. 6265] and shares were unwieldy as represented by the amount as stated by the books and unquestionably, there were a great number of things considered by the stockholders and the Directors in determining to increase the number of shares from 2,298 to 668,652 outstanding.

My memory also runs to the fact that the entire authorized capital stock had likewise been increased. There may have been some desire on the part of the stockholders to have the evidence of their ownership of Panhandle Eastern broken up into smaller pieces in order that they might deal more freely with them.

Along about the middle of 1936, Panhandle Corporation, an organization to which you referred a short while ago, transferred the common stock of Panhandle Eastern it owned to the receivers of Missouri-Kansas Pipe Line Company.

Missouri-Kansas Pipe Line Company, I believe, asked that the one large certificate for the total number of shares that it received be broken down into smaller pieces and, as I say, there were those and perhaps a great number of other things that entered into the consideration involving the stock dividend.

Q. Yes. Now, Mr. Watkins, you referred in your answer to a question of a few moments ago to two stockholders of Panhandle Eastern Pipe Line Company. Those stockholders were the Columbia Oil and Gasoline Corpora- [fol. 6266] tion and the Missouri-Kansas Pipe Line Company?

A. The Missouri-Kansas Pipe Line Company has not held stock as a corporation throughout the entire period.

It was about the middle of 1936 when Missouri-Kansas Pipe Line Company became the record holder of a portion of the common stock of Panhandle Eastern.

Apparently at that time, the stock that it became the record holder of had either been in the name of a voting trustee or Panhandle Corporation or maybe back in the early days, some other nominee.

Q. Might it not be well to explain at this point that the Panhandle Corporation was an entity set up by the Missouri-Kansas Pipe Line Company for the purpose of certain financing arrangements which it undertook in 1930?

A. I do not really know.

Q. I do not want you to go into the detailed explanation.

A. I do not really know the basis upon which it was set up. My personal observation of the corporation was that that might have been the case.

Q. Yes. Do you know whether or not, Mr. Watkins, the issuance of this 646,354 shares of common stock was brought about, in part, by a consent decree entered in the District Court of the United States for the District of Delaware on January 29, 1936, as a result of an anti- [fol. 6267] trust action brought by the United States Government?

A. Now, I am just a simple sort of a person. If you will not involve me in any actions that might have been brought by the Department of Justice or any consent decrees that may have been issued, I certainly will be obliged to you.

I have tried to say, in answer to your previous question, that it is my belief that the origin of the 646,354 shares was as a result of a wide variety of things, one of which might have been this particular transaction to which your question is directed.

Q. You personally, as secretary and controller of the company, are not aware of the facts with respect to that matter?

A. I would not say that. I am aware of the fact that there is a consent decree, that there was an anti-trust suit. Whether those particular circumstances were the only

circumstances that have anything to do with the issuance of the stock dividend, I do not know.

I presume that it probably did have something to do with it.

There may have been some provision in the consent decree or the stipulations I presume issued thereunder or concurrent with it that caused the issuance of these stock dividends.

Q. Can you say at the present time whether the minutes of the Board of Directors of the Panhandle Company [fol. 6268] would set forth in detail the reasons for the issuance of this amount of stock?

Mr. Wheat: Do you mean the Panhandle Company?

Mr. Gorman: That is right.

Mr. Wheat: Yes.

Mr. Gorman: Panhandle Eastern Pipe Line Company.

The Witness: I think there would be some reference, unquestionably, in the minutes of the meeting in which the stock dividend was declared as to its purpose.

Whether that statement would run to the anti-trust suit to which you referred to or to the consent decree, I am not sure that I know.

I believe Panhandle Eastern made an offer to issue certain shares of stock and to issue certain stock rights and to do certain other things to its stockholders somewhere along about June 19, 1935.

These transactions we are referring to might even have a part of their origin back in that offer.

By Mr. Gorman:

Q. I believe you stated, Mr. Watkins, that the 80,000 shares of stock which were purchased by one of the stockholders in 1936, whom I assume to be the Columbia Oil and Gasoline Corporation were purchased actually on a cash basis, were they not?

A. That is correct.

[fol. 6269] Q. And is that also true of the sales of stock

which took place in the year 1939 to which you made reference?

A. That is correct.

* * * * * * * *

I was not controller, of course, back in 1936.

Q. Well, we understand, of course, you were only secretary at that time.

Referring now to Line 3 of Page 2 of this exhibit, which is the account for preferred capital stock, at December 31, 1936, and continuing up to and including June 30, 1941, there was outstanding some $11,000,000 in this account.

Can you tell us whether or not this preferred stock was all issued for a cash consideration?

A. Yes, I can explain that.

Going back to the responses I gave with respect to the fact that Missouri-Kansas Pipe Line Company may not have been a record holder at all times of the stock it now owns, my mind is refreshed that there was a nominee of Panhandle Corporation involved.

I presume it is sufficient, so far as our interest in this matter is concerned, to refer only to Panhandle Corporation.

Now, as to the $11,000,000 principal amount of preferred [fol. 6270] stock which came into existence in 1936, we must turn again to the three-party agreement entered into to provide for the additional $10,900,000-odd of cash needed to complete Panhandle Eastern's construction program as it existed in the latter part of 1930 and to the fact that Panhandle Eastern thereafter issued certain of its notes, together with certain shares of stock, to the organizations advancing to it approximately $10,990,000 in cash.

This cash was advanced to Panhandle Eastern in equal amounts by Columbia Oil and Gasoline Corporation and by the Ottiwell & Company, the latter in behalf of Panhandle Corporation for construction requirements of Panhandle Eastern and its subsidiaries.

These advances, as the witness has stated, represented $90 in principal amount of Panhandle Eastern notes and two shares of its no-par common stock.

There were issued, during the years of 1931 and 1932, Panhandle Eastern Pipe Line Company's 6 percent promissory notes due October 2, 1950, aggregating $9,891,000. There had accrued but was unpaid in 1936, interest on such notes in excess of the difference between $9,891,000 and $11,000,000.

On February 6, 1936, according to the revised plan of readjustments of funded debt and capitalization of Panhandle Eastern Pipe Line Company dated June 19, 1935, Panhandle Eastern authorized the issuance of 94,000 shares [fol. 6271] of convertible cumulative preferred stock, having an aggregate par value of $9,400,000 and $1,600,000 principal amount of promissory notes convertible into convertible cumulative preferred stock at par at option of the holders, against the receipt for cancelation of $9,891,000 principal amount of 6 percent promissory notes due October 2, 1950, with unpaid and accrued interest thereon in the amount of $1,440,789, so the witness believes, to answer the question originally put; that the total of the $11,000,000 carried in Exhibit No. 48 on Page 2, Line 3, in Columns H, I, J, K, L and M was represented by cash or its equivalent.

* * * * * * * *

[fol. 6275] Q. Referring now, Mr. Watkins, to Line 6, Page 2, of this exhibit, which is the long-term debt accounted for by bonds, I note that in Column M as of June 30, 1941, there was outstanding a total of $18,250,000 in bonds and that prior to that year, specifically shown in Column I for the year 1937, there was outstanding a total of $24,000,000 worth of bonds.

Can you tell us the total amount of money which has been raised by the Panhandle Company through the issuance of bonds?

A. The actual dollars, no, without some preparation. There is, however, in the record testimony by this witness with respect to three major financial transactions involving bonds, aggregating, in the first instance, a total principal amount of $20,000,000; in the second instance, a total principal amount of $24,000,000; and, in the third instance, a total principal amount of $18,250,000.

If it is necessary to supply the actual dollars received by the company as a result of the sales of those securities, I will have to have that prepared.

Q. Before I discuss that, Mr. Watkins, can you tell us whether or not certain of the issues which you have just [fol. 6276] spoken of were used, in part at least, for the retirement of bonds which had been issued previous to such later transactions?

A. Yes, I can do that.

* * * * * * * *

Q. Without specific detail, I merely intended to ask a general question. I believe you answered by saying "yes."

What I meant by my question is this, I see you do not understand, that certain of your issues have been used, in part, for the retirement of outstanding bonds, have they not? A. That is correct.

* * * * * * * *

[fol. 6277] Q. Will your notes also indicate the amount of such money that was received that was used for the construction of plant and properties?

A. No, they will not, and I do not know how in the world one could determine such an amount because the proceeds of the sale of securities, along with any other funds that the company received, are thrown into a general bank account from which payments of varied nature are made, either for construction, for operation or for payment of salaries or any other payments that need be made in the ordinary course of business.

We have made no attempt whatever and I do not know how we would go about making an attempt to try to earmark the dollars that go into the general treasury.

Q. Of course, in making such statements, you are taking into consideration all of your books and records and the fact that they would not disclose such information?

A. The books and records do disclose the actual amounts expended for any purpose for which funds have been expended.

One could refer to the income statement introduced as Exhibit No. 49 in these proceedings and observe, for in-[fol. 6278] stance, that the operating and maintenance expense for the period from April 1, 1932, to December 31, 1940, as shown on Line 9 of Column K on Page 1 of Exhibit 49, have amounted to more than $15,600,000.

Now, obviously, that money had to come from some place and there is a complete and very definite record in the company's accounts as to what that money was spent for.

Further than keeping a most accurate record as to where the money is spent, what it is spent for, the account to which it ultimately must properly be charged, the company has no records that show how much of any dollar it received is spent for construction, maintenance, or for any other purpose.

Q. Has it been the experience, according to your information, Mr. Watkins, that in each succeeding issue of bonds the company has been able to acquire funds at a lesser amount of interest?

A. It has not only been the experience but that is the fact.

Q. Yes, that is what I meant by experience.

A. What the future will hold is an entirely different matter.

* * * * * * * *

[fol. 6282] LEITH V. WATKINS a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Mr. Wheat: Mr. Examiner, in connection with yesterday's cross-examination of Mr. Watkins, certain documents were referred to, and I should like to offer now for identification the following documents:

First, "Panhandle Eastern Pipe Line Company—Compiled Registration Statement", being registration No. 2-4919; date of filing, December 24, 1941; Amendment filed, January 20, 1942; effective date, January 21, 1942, as of January 12, 1942, covering issues of $10,000,000 first

mortgage and first lien 3 percent bonds, Series C, due January 1, 1962, and 150,000 shares of a yet unstated percent cumulative preferred stock (par value $100 per share) and I ask that that be marked with the next exhibit number.

Trial Examiner: The document which you have just described will be marked for identification as Exhibit No. 145.

(Exhibit No. 145 was marked for identification.)

Mr. Wheat: Second, I should like to offer similarly for identification a document entitled, "Prospectus—Panhandle Eastern Pipe Line Company—$10,000,000 First [fol. 6283] Mortgage and First Lien 3 Percent Bonds, Series C, Due January 1, 1962, and 150,000 Shares of (Unstated) Percent Cumulative Preferred Stock, (Par Value $100 Per Share)" dated January 21, 1942.

Trial Examiner: This will be marked for identification as Exhibit No. 146.

(Exhibit No. 146 was marked for identification.)

Mr. Wheat: In addition, I would like to have marked for identification, with the right to withdraw later and substitute a typed copy, an order of the Securities and Exchange Commission made at a regular session of the Commission at its office in Washington on the 21st day of January, 1942, "In the Matter of Columbia Gas and Electric Corporation, Columbia Oil and Gasoline Corporation, Panhandle Eastern Pipe Line Company, Michigan Gas Transmission Corporation, Indiana Gas Distribution Corporation and The Ohio Fuel Gas Company, File Nos. 59-33, 70-263, 70-371, 70-387, 70-430 and 70-431, under Public Utility Holding Company Act of 1935."

* * * * * * * *

Trial Examiner: This is the order, I take it, which entitles the Panhandle Eastern Pipe Line Company to ac- [fol. 6284] quire certain interests in the Michigan Gas Transmission Corporation?

* * * * * * * *

Trial Examiner: Very well, we will mark this Order to which you have just referred as Exhibit No. 147 for identification.

* * * * * * * * *

[fol. 6285] Mr. Wheat: May I say with respect to Exhibit No. 146, that this is a bidding prospectus and not the one which offers the securities in question to the public.

I think that distinction is one which possibly should be made of record.

Now, Mr. Examiner, I would also like to offer for identification, also with the right to substitute a mimeographed copy for this typewritten and carbon copy, the Order of the Securities and Exchange Commission in File No. 2-4919, "In the Matter of Panhandle Eastern Pipe Line Company", made at the session of the Securities and Exchange Commission on January 21, 1942, consenting to the filing of amendments to the Registration Statement.

I think that will make the entire group of these documents complete.

Trial Examiner: This will be marked for identification as Exhibit No. 148.

* * * * * * * * *

[fol. 6287] The Witness: In some of the answers to questions put to me yesterday, I may have referred to Columbia Oil and Gasoline Corporation as a stockholder of Panhandle Eastern Pipe Line Company.

Subsequent to the consent decree to which Mr. Gorman made reference during yesterday's proceedings, the stock of Panhandle Eastern Pipe Line Company, beneficially owned by Columbia Oil and Gasoline Corporation, was registered in the name of Gano Dunn, Trustee for Columbia Oil and Gasoline Corporation, appointed pursuant to a decree dated January 29, 1936, in Cause 1099, in Equity in the District Court of the United States for the District of Delaware.

* * * * * * * * *

The Witness: If I may at this juncture, however, suggest that if we could, each time we refer to Columbia Oil

as a stockholder, if such reference is hereafter made, understand we are referring to its beneficial interest and not to the fact it is a record owner subsequent to January, 1936, it might simplify our work.

Mr. Gorman: Can you advise us at this time, Mr. [fol. 6288] Watkins, whether or not that trusteeship is still in effect?

The Witness: It is.

Mr. Gorman: However, as you have indicated, Columbia Oil and Gasoline Corporation is the beneficial owner of such stock?

The Witness: That is correct.

* * * * * * * * *

[fol. 6290] Now, as to the information requested yesterday which the witness is prepared to supply, shall we proceed with that?

Mr. Wheat: Mr. Gorman, would that be satisfactory now?

Mr. Gorman: Yes, quite.

Mr. Wheat: It seems to me that would be a good method to handle this.

Mr. Gorman: Yes, I am agreeable to that.

Mr. Culton: These are the special deposits, are they not?

The Witness: That is correct and the breakdown which the witness is about to supply is that referred to in the question appearing on Lines 7, 8 and 9 at Page 6185 of the transcript of yesterday morning's session.

[fol. 6291] "Special Deposits", amounting to $1,489,127.23 as of June 30, 1941, appearing on Line 6 of Page 1 of Exhibit 48 in Column M. consisted of:

First mortgage and first lien bonds, Series A, 4 percent, due March 1, 1952, City Bank Farmers Trust Company, paying agent (called for redemption March 1, 1941)—$3,820.

First mortgage and first lien 3 percent bonds, Series B, due November 1, 1960, City Bank Farmers Trust Company—paying agent,—$2,055.

Those two items make a total of $5,875.

Miscellaneous Special Deposits are as follows:

Sinking Fund—first mortgage and first lien bonds, Series A, 4 percent, due March 1, 1952, City Bank Farmers Trust Company-Paying agent (called for redemption March 1, 1941)—$9,000.

Funds for redemption of first mortgage and first lien bonds, Series A, 4 percent, due March 1, 1952, City Bank Farmers Trust Company-Paying agent (called for redemption March 5, 1941),—$1,473,524.23.

Funds in Escrow consisted of:

Service Deposits made with the City of Belton, Missouri	$5.00;
City of Hugoton, Kansas,	$40.00;
Missouri Public Service Company,	$5.00;
Kansas Utilities Company,	$3.00;

[fol. 6292] These comprise a total of $53.00.

Right-of-Way Deposits consisted of:

State Highway Commission of Kansas, amounting to	$25;
Jackson County, Missouri Highway Department,	$50;
Making a total of,	$75.

There was also a deposit for guaranty of insurance premium with Zurich General Accident and Liability Insurance Company, amounting to $600.

The total of the Miscellaneous Special Deposits was $1,483,252.23 which, taken together with the interest special deposits amounting to $5,875 as an aggregate, made up the total of special deposits amounting to $1,489,127.23 as shown on Exhibit No. 48 at the place hereintofore referred to.

Cross-Examination (Continued)

By Mr. Gorman:

Q. Do you have any other statements that you desire to make, Mr. Watkins, before we proceed?

A. Yes, I do.

At Lines 19 and 20 on Page 6192 of the transcript of yesterday morning's session, the witness was requested to supply for the record the balance in the materials and supplies account as at December 31, 1941.

This amount was $374,839.09, and to completely clear up the record—

Q. (Interposing) Mr. Watkins, before you proceed to [fol. 6293] another subject, does that figure which you have just given represent the closed account or is that account still open for further adjustments prior to closing?

A. As far as I know, it is completely closed. However, if it does not represent the final balance in the account comparable with such balances shown elsewhere at different periods on Exhibit 48, the witness will advise the Commission in some proper manner of whatever the difference may be.

Q. But, in so far as you know at the present time, that does represent the amount which will be in the closed account as at December 31, 1941?

A. That is right.

Now, at Lines 16, 17 and 18 on Page 6211, the matter was left if there be no reason for changing the statements made by the witness, the statements would stand as correct.

Mr. Wheat: To what does that refer?

The Witness: That referred to the fact that there had been no extraordinary property losses experienced by Panhandle Eastern.

The witness has verified the fact and the statements heretofore made in that respect are absolutely correct.

[fol. 6295] By Mr. Gorman:

Q. Mr. Watkins, will you please refer to Page 2 of Exhibit No. 48, Line 6, the account "Long Term Debt-Bonds", and particularly to Column M which shows the status of this account as of June 30, 1941.

A comparison of the amounts shown as of that date of $18,250,000 with the amount shown at December 31, 1940, of $22,500,000 indicates that certain bond retirements have been made during the first six months of 1941.

Can you tell us briefly of the transactions which resulted in such diminishment of the bond account of the bonds outstanding?

A. As a result of certain financial transactions consummated as of February 3, 1941, a portion of which was accomplished following the making effective of Registration No. 2-4975 on Form A-2 filed with the Securities and Exchange Commission on November 18, 1940, under the Securities Act of 1933, there were issued and sold on February 3, 1941, $12,000,000 principal amount of Panhandle Eastern Pipe Line Company Series B bonds and, at the same time, $6,250,000 of Panhandle Eastern's Series A bonds, and $5,000,000 principal amount of Serial notes, a more complete description of such securities the witness believes is in the transcript of his original testimony in response to questions directed to him by Mr. Wheat. My remembrance is that the maturities of the securities is [fol. 6296] stated in complete detail in the record.

Having issued and sold these securities, coincident with their delivery, there was deposited with the Corporate Trustee under the company's previous mortgage trust indenture an amount sufficient to redeem the full principal amount and accrued interest on a prior issue of 4 percent bonds.

Is that sufficient, sir?

Q. I think it is, yes.

Can you tell us also whether or not certain refinancing operations are proposed to take place pursuant to an order granted by the Securities and Exchange Commission which has been identified as Exhibit No. 147 and the concurrent findings which are identified as Exhibit No. 148?

A. Yes, I can, and they consist of the expectation of the company to issue and sell $10,000,000 principal amount of first mortgage and first lien 3 percent bonds, Series C, due January 1, 1962, and 150,000 shares of cumulative preferred stock with a par value of $100 per share, all of which is more fully described in Registration Statement No. 2-4919, and in the bidding prospectus, both of which documents have been heretofore identified in these proceedings as Exhibits Nos. 145 and 146, respectively.

Q. Is the purpose of this proposed financing operation to acquire additional ~~properties or will~~ they also result in certain refunding operations? If the answer is [fol. 6297] completely set forth in these exhibits to which you have made reference—

A. (Interposing) The answer is completely set forth and on Page 66 of Exhibit No. 145 is a part of Item No. 28 which is not yet fully complete.

These details are shown with respect to approximately how the net proceeds from the sales are to be applied.

Would counsel like for that information to be read into the record or shall we leave the matter by referring to the item?

Q. I think it might be well for the witness to read into the record that portion of the answer to Question No. 28 which appears on Page 66.

Mr. Wheat: Of which Exhibit, No. 145?

Mr. Gorman: Of Exhibit 145.

Mr. Culton: The same information appears on Page 3 of the Prospectus, Exhibit No. 146, does it not?

The Witness: That is correct. In the Prospectus, the designation of the section is, "Application of Proceeds".

In the registration statement, the item is identified as "Furnish a reasonably itemized statement of the approximate amount devoted to each purpose, so far as determinable, for which the net proceeds have been or are to be used."

In said Item No. 28, there appears the following tabulation:

1. To the purchase from Columbia Gas & Electric Cor-
[fol. 6298] poration of all the outstanding securities (stock and indebtedness) of Michigan Gas Transmission Corporation, $10,676,000.

That amount is followed by an asterisk referring to a footnote which reads as follows:

"This figure will be adjusted upward or downward in an amount equal to the increase or decrease, as the case may be, of the surplus of this corporation during the period between September 30, 1941, and the date of purchase."

Section No. 2 reads as follows:

"To the purchase from Columbia Gas & Electric Corporation of all the outstanding securities (stock and indebtedness) of Indiana Gas Distribution Corporation. $154,000.

The note previously read in connection with Item No. 1 likewise refers to this amount.

Section No. 3:

"To the purchase from The Ohio Fuel Gas Company of certain natural gas pipe lines in Indiana and Ohio. $439,000.

No. 4:

"To the redemption of all of the Company's outstanding Class A Preferred Stock (now owned beneficially by Columbia Oil & Gasoline Corporation), exclusive of accrued dividends which will be paid out of the Company's general funds. $10,000,000.

Item No. 5:

"To the payment of part of the cost of construction
[fol. 6299] work now authorized as more fully described in Item 7 hereof."

There is no amount shown opposite No. 5 but, in the position where the amount would ordinarily [shown] are two asterisks referring to the following footnote:

"The balance (estimated at blank dollars as of September 30, 1941) of the payments of the cost of con-

struction work now authorized, is to be made from the general funds of the Company."

There follows a footnote referring to all of Item No. 28 reading as follows:

"The answer to this Item 28 will be amended by post-effective amendment to this Registration Statement to show the amount of funds, other than from net proceeds, that will be paid from the general funds of the Company for the purposes aforesaid."

The witness neglected to read, but perhaps the record should show, that preceding the tabulation of the application of the proceeds of the sale of securities to which reference has been made, the Prospectus on Page 3 makes reference to the net proceeds after deducting expenses in connection with the issue and sale of said bonds and preferred stock.

In connection with Portion No. 5 of Item 28 appearing on Page 66 of the Registration Statement, and here it might be noted that we have been referring to this as a "Registration Statement", whereas it states on its very [fol. 6300] face that it is a "Compiled Registration Statement", meaning that it is a compilation of the original Registration Statement and Amendment No. 1 thereto.

I believe I was referring to Section No. 5 of Item 28 on Page 66 of the Compiled Registration Statement which refers to construction work authorized and described in Item 7 of the Compiled Registration Statement.

Item 7 carries a description "Property" and neglecting all of the answer to Item 7 except that portion appearing on Page 23 under the general heading "Authorized Construction Work", there appears the following:

"During the year 1941 the Company authorized certain construction work, a large part of which is now in progress, involving expenditures then estimated at approximately $9,000,000, in order to extend natural gas service to a number of communities in the State of Michigan and increase the peak load delivery capacity of its system. It is anticipated the ultimate cost of such work

may exceed such estimate by approximately 10 percent. The principal construction work includes:

"(1) Construction of approximately 256 miles of 20-inch, 18-inch, 16-inch and 12¾-inch pipe line in the State of Michigan for the purpose of delivering natural gas from the Michigan Gas Transmission Corporation system to Consumers Power Company and others;

[fol. 6301] "(2) Construction of aproximately 146 miles of 26-inch, 24-inch and 20-inch pipe line parallel to the Company's present system in the States of Kansas, Missouri and Illinois, and

"(3) Installation of additional gas engine driven compressors in the Company's Pleasant Hill, Glenarm and Tuscola compressor stations.

The Company estimates that all presently authorized construction work will be completed by July 1, 1942."

Which ends the quotation from Page 23 of the Compiled Registration Statement under the general heading "Authorized Construction Work", being a part of Item No. 7 thereof.

By Mr. Gorman:

Q. Mr. Watkins, in connection with the matters which you were discussing, specifically the purchase from Columbia Gas & Electric Corporation of the outstanding securities, including stock indebtedness of the Michigan Gas Transmission Corporation of an amount stated in this Item 28 which you have been reading of $10,576,000, reference to Item 29, part A thereof, indicates that the items to be purchased are certain demand notes and certain demand loans which are respectively $5,900,500 and the demand loans being $2,420,000, aggregating, as I add it, $8,320,500, plus common stock which is said to be stated on the books of Michigan Gas Transmission Corporation of $2,240,000. [fol. 6302] As I add the total of these three items, it produces a result of $10,560,500 which is approximately $115,500 difference from the figure stated in Item 28. Will you explain the items, if any, which comprise this difference of $115,500 or can you invite my attention to any part of this exhibit No. 145 which would explain that difference?

A. You find approximately $150,000 less—

Q. (Interposing) My total of the three items which I mentioned specifically, demand notes, loans and stated stock [stock] value, aggregate $10,560,500 as compared with the stated total in Item 28 of $10,676,000 which is a difference, I believe, of $115,500.

A. As the note on Page 28 referring to the Item $10,676,000 indicates, an adjustment must be made in the amounts at which these securities are carried on the books of Columbia Gas & Electric Corporation with respect to the surplus at the time of acquisition.

Mr. Wheat: You referred to Page 28. You mean the answer to Item 28 on Page 66?

The Witness: Thank you very much.

Mr. Wheat: On Exhibit 145.

The Witness: That is exactly what I meant.

The order issued by the Securities and Exchange Commission provides for an adjustment of Columbia Gas' investment in these securities [downard] by an amount, I [fol. 6303] believe, that ranges around $130,000 odd.

If you have a decided interest in this difference, I shall be glad to work it out for you, either ~~at noon~~ or this evening.

By Mr. Gorman:

Q. No, I think that it will be satisfactory, Mr. Watkins. As I understand your statement, this total of $10,676,000 is interpreted, for the purpose of the proposed purchase, to be the investment of the Michigan Gas Transmission Corporation in its properties, is that correct, properties and other assets?

A. It would hardly be proper to say that as the plan provides and as the Registration Statement speaks and as the Order of the Securities and Exchange Commission speaks, the acquisition is to be made on the basis of the investment of Columbia Gas & Electric Corporation in these securities as of September 30, 1941, adjusted upward or downward for the amount of surplus created by Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation up to the time they are actually acquired by Panhandle Eastern Pipe Line Company and provides further for an adjustment in Columbia Gas &

Electric Corporation's investment by the amount the witness previously referred to, ranging around $125,000 to perhaps $130,000.

That adjustment is one which represents some fees in-[fol. 6304] curred in connection with the original construction after having reduced such fees, their original amount having been, as I believe, about $165,000, by the amount of depreciation provided by the company since the date such fees were incurred.

It is somewhat difficult to give expression, in a document that has not yet become effective and which depends on a transaction to be consummated at some time in the future, to an exact, precise amount.

Mr. Culton: The price is based on Columbia's investment in these properties?

The Witness: That is correct, plus the surplus less this adjustment that we have just referred to.

By Mr. Gorman:

Q. Wouldn't the result of the statement that you have just made that the figure resulting after the calculation is made, according to your explanation, wouldn't the result be the net investment of the Michigan Gas Transmission Corporation as of the time of acquisition by Panhandle Eastern Pipe Line Company of the properties and assets of the Michigan corporation?

A. You may interpret it that way sir, if you wish. As far as the witness is concerned, the Compiled Registration Statement clearly defines the basis upon which the properties are about to be acquired.

As far as this witness knows, there has been no discus-[fol. 6305] sion, plans or anything else that would indicate that the purchase is based on anything other than the investment of Columbia Gas and Electric Corporation in the securities as of a certain date plus or minus the adjustments I have described.

Q. Yes.

A. If that connotes to you net assets, why, that would be entirely all right, I suppose.

Q. Well, would it not be a true statement to say that the aggregate of these outstanding notes and loans and the

common stock as of the value stated represents the equities in these properties and other assets of the corporation?

A. Let's put it this way, sir. They will represent at the date Panhandle Eastern acquires the properties, if it ever does, the amount that Panhandle Eastern is perfectly willing to pay for them regardless of how it came into existence.

There are reams and reams and reams of description and testimony in Combined Docket No. 59-33, I think, in the Securities and Exchange Commission to which the witness might suggest reference be made if further or more complete details are desired than those shown in the combined Registration Statement and Prospectus offered here and identified as Exhibits Nos. 145 and 146.

Q. What is your answer to my previous question, Mr. Watkins, with respect to the equities of the company as [fol. 6306] divulged by the balance sheet of Michigan Gas Transmission Corporation?

A. I have no answer to it, sir. I do not understand it.

* * * * * * * * * * *

[fol. 6319] Q. Do you have any understanding of the phrase "equity in the property"?

A. Your questions directed to me with respect to Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation may tend to develop some data with respect to whether or not Panhandle Eastern was purchasing equities or purchasing something else in the event it is entitled to acquire these properties. I should like to let my answer take this form:

I have no doubt ~~, whatever,~~ that each of the figures and all of the data included in Exhibit 145 with respect to Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation are anything other than an exact statement of those amounts and that data with respect to those companies, in other words, that they are entirely accurate whether they represent reasonable costs, whether they represent equity; whatever they represent, the statements are included in the Registration Statement. They are adopted by Panhandle Eastern Pipe Line Company, they have been certified to by independent public accountants for all periods with the exception of September 30, [fol. 6320] 1941, and are unquestionably correct.

Now, if the specific thing you are trying to get me to say is whether or not, aside from any purpose for which these statements may have been included in this Registration Statement, it is possible to determine the equity in a corporation from its balance sheet, the answer, naturally, is yes.

Q. Yes, that is what I have been seeking all the time, Mr. Watkins.

A. And the customary manner in determining that is to observe its surplus.

Q. Without reference to the stock or bonds outstanding?

A. Well, if we are talking about net equity without respect to debt—

Q. (Interposing) Yes.

A. (Continuing) —we must refer to surplus. If we are talking about the net assets of a corporation, I should think we are referring to a simple deduction of the total assets less the total liabilities excluding debt, stock and surplus. Does that help you, sir?

Q. Well, yes, and then, again, no.

Turning now to page 66 of this Exhibit 145, referring to Item 29 on that page, can you tell us whether or not the total of the demand notes, which is stated at $5,900,500, [fol. 6321] plus the stated amount of the demand loans of $2,420,000, plus the stated book value of the common stock of $2,240,000 plus surplus represents the equity and investment of the owners, including the creditors of the Michigan Gas Transmission Corporation as reflected in the figures which I have read?

A. I doubt seriously, sir, whether it can represent both equity and investment. Now, actually, the amounts you have enumerated represent simply this: The debt of Michigan Gas Transmission Corporation to Columbia Gas & Electric Corporation in the form of demand notes and demand loans and the amount at which it, Michigan Gas Transmission Corporation, carried its 44,800 shares on its books. Those sums, those amounts added, including the surplus of Michigan Gas Transmission Corporation, less the adjustment that they spoke about heretofore, is approximately the $10,676,000 shown in Part No. 1 to Item 28 on page 66 of the Registration Statement.

(Discussion off the record)

By Mr. Gorman:

Q. Mr. Watkins, in your answer you indicated a doubt as to whether or not the figures which I have read properly represented the investment of the Michigan Gas Transmission Corporation in property and other assets held by that company.

[fol. 6322] Mr. Wheat: Now, Mr. Gorman, wouldn't you prefer to put that as a question? I do not believe it is quite fair to the witness to state that he indicated a doubt. He said that it could not be both, probably, or would not represent both the equity and investment.

I am wondering if that would not be fair to the witness, to put that as a question, rather than to make a statement on the record.

Mr. Gorman: I was going to put the following question, but it was a matter of clarification. Suppose we have the witness' previous answer read back so that I may be correct.

(Record read)

The Witness: Let me see if I can clear up this whole thing.

By Mr. Gorman:

Q. I will appreciate it if you can.

A. Michigan Gas Transmission Corporation has an indebtedness to Columbia Gas & Electric Corporation according to the portions of the Registration Statement to which we have been referring and according to the statements included in the Registration Statement, the accuracy of which the witness has already testified to, amounting to \$8,320,500. That is in the form of demand notes and demand loans, and here we are speaking as of the date re-[fol. 6323] ferred to in the Registration Statement.

The equity of Columbia Gas & Electric Corporation in the form of common stock is represented by the 44,800 shares of common stock without par value of Michigan Gas Transmission Corporation which it, Columbia Gas, owns.

I believe it is stated, perhaps in this Registration Statement, or at some other place, that Columbia Gas carries that on its books at $2,240,000.

* * * * * * * *

Q. Yes, your answer there indicates that this common stock represents the equity of the Columbia Gas & Electric Company in the Michigan Gas Transmission Corporation. Isn't that correct?

A. In the form of common stock, yes. Whether that value represents the entire value of such equity, I make no pretense of trying to testify.

Q. Now, of course, you must understand, Mr. Watkins, that we are dealing at all times with these figures which I understand were taken from the books and records of the Michigan Gas Transmission Corporation and which reflect items excerpted from the balance sheet of that corporation, do they not? A. That is correct.

Q. Yes.

Mr. Wheat: May I ask, Mr. Watkins, what was the [fol. 6324] principal amount of that adjustment referred to in the order of the Securities and Exchange Commission?

The Witness: In the neighborhood of $105,000.

By Mr. Gorman:

Q. Is it correct for me to understand, Mr. Watkins, from your various statements that your hesitancy in expressing an opinion as to whether or not the total of these figures represents the investment in the properties and assets of the Michigan Gas Transmission Corporation is due solely to your inability to state specifically that the common stock is of the value of $2,240,000, which is carried on the books of the Michigan Gas Transmission Corporation?

A. That does not seem to be the proper statement of my position at all. I have no hesitancy in making any representation that I properly know. I am not an officer of Michigan Gas Transmission Corporation, I am not an officer of Columbia Gas & Electric Corporation, I know nothing about their books or records except those things that it has become necessary for me to learn as a result of the pendency of the possible acquisition of certain

securities, and so forth, from them. I have no doubt, however, but that the $2,240,000, if stated in the Registration Statement as the amount at which Columbia Gas & Electric Corporation carries its investments in Michigan Gas [fol. 6325] Transmission Corporation's common stock, is correct.

Furthermore, Panhandle Eastern took the precaution when, in June of this year, Columbia Gas & Electric Corporation and Missouri-Kansas Pipe Line Company entered into an agreement, reference to which I believe has heretofore been made in the proceedings, to forthwith have its public accountants, Messrs. Arthur Anderson & Company, determine from the books of Columbia Gas & Electric Corporation just what these amounts were. We have a report from the accountants with respect to that and that report is, I believe, a part of the proceedings in the Securities and Exchange Commission, Consolidated Docket No. 59-33, if I remember correctly, to which I respectfully refer you for further information.

Mr. Culton: I wonder if Mr. Gorman had noted how closely the capital stock and surplus come when added to the loans and notes to making the $10,676,000?

Mr. Wheat: May I state the figures for you, Mr. Gorman?

Mr. Gorman: I am not denying that figure in any way.

Mr. Wheat: Just for your information, may I state the figures, which, looking at page T-3, Michigan Gas Transmission Corporation balance sheets, if you add the items of demand notes, demand loans and common stock, and then add the three items of surplus stated on the bal- [fol. 6326] ance sheet, will give you a total of $10,780,840.59.

Now, if you deduct from that the $105,000 adjustment which the witness has stated to be an approximation of the adjustment which must be made, you have $10,675,840.59, or a difference of only $159.41 out of the $10,676,000 figure stated on page 66.

I don't know whether that helps you or not, but if that adjustment mentioned by the witness were $159.41 out of $105,000, the figures would be exactly the same.

Mr. Gorman: I accept that as accurate. As a matter of fact, my questions have not, I hope, indicated anything to the contrary.

Mr. Wheat: No, they have not, I just thought, possibly, that might assist you in this matter.

Mr. Gorman: But taking those figures which you have just read, and the aggregate result which they produce, my questions have been solely directed to this witness to determine whether or not that is considered by the proposed purchaser, Panhandle Eastern Pipe Line Company, to represent the investment of the Michigan Gas Transmission Corporation in its properties of gas plant, and other assets. That, stated very concisely, is the whole question that I have been attempting to secure an answer to from this witness. That is the net investment, of course, that I was referring to.

[fol. 6327] As a matter of fact, stated even more simply, if we put that on one side of the page, that is, these amounts which I have termed, appropriately or inappropriately, as equities of the owners and creditors, my question which is directed to this witness is to find out what would be put opposite that to balance it on the other side of the page.

I do not know that I can ever, if we stay here all day, state it more concisely or simply than that.

Mr. Wheat: Are you in a position to answer that question?

The Witness: I do not understand that to be the question.

Mr. Wheat: I understood Mr. Gorman to say that was the question.

By Mr. Gorman:

Q. I will say, can you put the balance on the other side of the sheet to the last illustration I gave?

A. The first part of your question, if I remember it correctly, now that we are considering your statement a question, had to do with whether or not this witness could state certain things with respect to the investment of Michigan Gas Transmission Corporation. Maybe you

did not include Indiana Gas Distribution Corporation, but I presume you intended to do so.

[fol. 6328] Q. No, we are dealing solely, at the present time, with Michigan Gas Transmission Corporation.

A. In properties and so forth. With the hope that this answer may avoid any further time in this matter—

Q. (Interposing) I will go along with you in the hope.

A. (Continuing)—let's have a look at the balance sheet of Michigan Gas Transmission Corporation on page T-3 of Exhibit No, 145 where we note that the total assets at December 31, 1940, and September 30, 1941, are stated at $14,413,819.06 and $14,303,305.07, respectively.

Now, if we deduct from those amounts the sum total of all of the liabilities except the $8,720,500 and $8,320,500 representing, respectively, at December 31, 1940, and September 30, 1941, notes and loans payable to Columbia Gas & Electric Corporation and the $2,677,945.07 and $2,460,340.59 representing, respectively, at December 31, 1940, and September 30, 1941, the combined capital stock and surplus of Michigan Gas Transmission Corporation, we have the net assets of that corporation.

After you have made those computations, if you make them correctly, I shall immediately adopt them, sir, as being correct.

Q. Thank you.

Now, so that we may all readily understand the answer, [fol. 6329] may it be read back by the reporter, please?

(Answer read)

The Witness: May I have the privilege of adding, after we have the net assets as stated by the books—

Mr. Gorman: Yes.

The Witness:—of Michigan Gas Transmission Corporation.

Mr. Gorman: As shown by this balance sheet to which reference has been made?

The Witness: Correct.

By Mr. Gorman:

Q. And would you, also, say, Mr. Watkins, that the addition of the figure of $8,320,500 and the figure of $2,460,346.59 would represent the investment by the owners and stockholders, including creditors, of the Michigan Gas Transmission Corporation in the net assets as shown by this balance sheet?

A. The balance sheet, itself, does not show, so far as I know, the investment by the owners, and when we say "owners", I presume we are speaking of Columbia Gas & Electric Corporation. This balance sheet refers entirely to the affairs of Michigan Gas Transmission Corporation and to the extent that it refers to the affairs of Michigan Gas Transmission Corporation it is, unquestionably, correct in every respect.

[fol. 6330] Q. And you say that it has no relation to investment?

A. I do not say that, sir.

Q. Did you not say—

A. (Interposing) I simply said that the balance sheet of Michigan Gas Transmission Corporation gives no evidence whatever of the investment of the owners, and when we refer to "owners" we must be referring to Columbia Gas & Electric Corporation. That is as far as I go in that connection. I do not know what Columbia Gas & Electric Corporation's investment is other than, as I have previous explained, reported to us by Messrs. Arthur Anderson & Company. and I have given counsel for the Commission the place where he may go to obtain a copy of that, refer to it and find out whatever it is that he is seeking with respect to Columbia's Gas investment.

Q. Well, of course, I think you will recall, Mr. Watkins, that my question included not only owners as represented by the holders of the common stock, but the creditors of the company who hold the demand notes and demand loans which aggregate the total of $8,320,500, to which I made reference.

A. Well, you will have to break such a question as that in parts. I cannot deal with it in that form in any fashion whatever.

[fol. 6331] Q. Do you have before you a copy of the findings of the Securities and Exchange Commission which has been identified as, I believe, Exhibit No. 147?

A. I have before me an order of the Securities and Exchange Commission. The order of the Securities and Exchange Commission which has been identified as Exhibit No. 147 in these proceedings has been sent to the photostatic organization who will reproduce the copies necessary for distribution.

The Exhibit, as you will recall, was received and marked for identification with the right of substitution later in the day. We are having the copies prepared for substitution.

* * * * * * * * *

Q. May I ask, Mr. Watkins, whether you are generally familiar with the terms and the conditions of the proposed findings and opinions of the Securities and Exchange Commission?

A. You may.

Q. Well, are you familiar with that?

A. I am not. I zipped through the thing when it came [fol. 6332] out two or three days ago in about ten minutes to find out what the general purport was and further than that I have no knowledge of it.

Q. Do you know whether or not such opinion contains a statement as follows, which I quote:

"The price fixed in the application for the sale and acquisition of Michigan Gas is stated to be the actual investment of Columbia Gas therein plus any undistributed surplus of Michigan Gas at the time of the consummation of the transaction. With the exception of one item the record indicates that the figure stated in the application, \$10,780,-840.59, as constituting the investment of Columbia Gas and Michigan Gas, plus surplus at September 30, 1941, constitutes actual system expenditures, and is equal to net plant account after depreciation less the excess of current liabilities over current assets."

A. I may have observed that when I read the proposed findings. I attach no special significance to it. I presume the staff of the Securities and Exchange Commission are qualified to properly interpret documents and information filed with them so that they may correctly reach the conclusion stated in the proposed findings.

I have not made the computations, I cannot specifically [fol. 6333] answer you. I assume they are correct. If the Securities and Exchange Commission state they are correct, I believe I would accept their statements.

Q. Yes. Well, was not that proposed opinion and findings submitted to the Panhandle Eastern Pipe Line Company for examination and possible argument upon any objections which they might have to the proposed findings and opinion?

A. To the extent that a copy of it was submitted to the General Counsel for Panhandle Eastern Pipe Line Company, I presume we would very naturally say that it had been submitted to the company. Actually, as far as I know, there was never a copy sent directly to the company and I have wondered, to some extent, about that, because I know that copies of the proposed findings were sent to other organizations involved without the procedure of approaching them through their counsel.

Certainly we had copies of it after the general counsel received it, but my answer to you is that the only way that it was presented to the Panhandle Eastern was through its general counsel. That may be proper procedure under the Securities and Exchange Commission's rules of practice, I do not really know.

Q. Do you know whether the submission of it to the general counsel of the company was for the purpose which [fol. 6334] I mentioned specifically, for the purpose of voicing any objections that they might have thereto?

A. I did not see any communications that came with it to the general counsel. I had general knowledge, the same, I believe, as most of the officers and men connected with the various companies who were participating in these proceedings, that there would be tentative or proposed findings distributed and that there would be an invitation to the participants to appear, argue, file briefs or whatever you do in a matter of that nature. I believe the date upon which those appearances was to have taken place was last Friday. I am not too sure about that. Whether there were any appearances, whether there were any arguments, whether there were any briefs filed, whether there were any exceptions taken to the proposed findings, I do not rightly know. My remembrance is that I heard one

or two representatives of some of the participants state they thought the proposed findings were ship-shape.

Mr. Lee: Pardon me: You are familiar with the fact, are you not, that all the parties in interest in that case,—City of Detroit was an intervener,—had copies of the proposed findings and that last Friday, January 23, 10:00 A. M., was the time set before the Securities and Exchange Commission for the purpose of filing objections, if any, and that nobody appeared and no objections were filed?

[fol. 6335] The Witness: I believe I stated, Mr. Lee, that I thought it was Friday the 16th, did I not?

Mr. Lee: That is right.

The Witness: I will accept your correction as to the date.

Mr. Lee: No, it was the 16th.

* * * * * * * *

By Mr. Gorman:

Q. Do you know, Mr. Watkins, whether or not your general counsel did make exception to this proposed opinion and findings and specifically to the paragraph which I have quoted?

A. We thought the findings were swell. So far as I know we have no reason to object to them, sir, and I feel rather sure that our general counsel did not object.

[fol. 6336] Q. Well, did you agree with the principles in the statements made in the paragraph which I quoted?

A. I will have to let my previous remarks with respect to that answer this question, sir. I believe I stated rather fully what my view was in answer to your previous question. I do not know how I can enlarge on it. I do not believe I could make it any more precise.

* * * * * * * *

[fol. 6337] Q. Well, I would like to get your opinion, of course, Mr. Watkins, on different things.

Now, the paragraph which I quoted mentions a figure of $10,780,840.59, which is a total of the figures to which you made reference to previously on page T-3 of Exhibit No. 145 in the amount of $8,320,500 as representing notes

and loans payable to the Columbia Gas & Electric Corporation, and the figure of $2,460,340.59, as representing the total capital stock and surplus.

Now, appreciating these component parts and the significance of the statement you have made heretofore with respect to these component parts, are you in agreement with the statement which I have read from the reported paragraph of the proposed findings and opinion to the effect that, "With the exception of one item the record [fol. 6338] indicates that the figure stated in the application, $10,780,840.59, as constituting the investment of Columbia Gas and Michigan Gas, plus surplus at September 30, 1941, constitutes actual system expenditures, and is equal to net plant account after depreciation, less the excess of current liabilities over current assets."

Now, are you in agreement with this quotation in so far as it states that it constitutes the investment of Columbia Gas and Michigan Gas, plus surplus, and, also, constitutes actual system expeditures and is equal to net plant account after depreciation, less the excess of current liabilities over current asset?

* * * * * * * * * * *

[fol. 6343] A. Here we go again, sir. I do not know anything about the Securities and Exchange Commission's proposed findings. I do not knew anything about the books and records of Columbia Gas & Electric Corporation. I am quite willing and have said repeatedly this morning that to the extent that information is included in Panhandle Eastern Pipe Line Company's Registration Statement with respect to Michigan Gas Transmission Corporation or with respect to Columbia Gas & Electric Corporation, or with respect to any other corporation or individual that I stand squarely behind them.

Now, if I may say this, I have no reason in my own mind, I have not the slightest hesitancy, whatever, to state [fol. 6344] that if Michigan Gas Transmission Corporation, if Columbia Gas & Electric Corporation, or if the Securities and Exchange Commission represent these

amounts you have been discussing as what you characterize them, that they are exactly those things.

* * * * * * * * *

[fol. 6345] LEITH V. WATKINS a witness, having been previously duly sworn, resumed the stand and testified further as follows:

* * * * * * * * *

[fol. 6346] By Mr. Gorman:

Q. Mr. Watkins, continuing with our discussion of the items disclosed on Page 2 of Exhibit No. 48, I invite your attention now to Line 7, which is the account, "Miscellaneous Long Term Debt", which, at June 30, 1941, is indicated in Column M as $5,017,543.80.

Does this amount represent certain notes of the company which are outstanding and certain cumulative interest thereon?

A. It represents certain notes that were outstanding at June 30, 1941, the nature of which has heretofore been testified to by this witness but does not include any interest on such notes or on any other of the company's obligations for, as you will observe, the amount of interest accrued for whatever purpose at June 30, 1941, is shown on Line 17 in Column M on Page 2 of Exhibit No. 48, and my remembrence is that details information concerning such accrual has heretofore been made a part of the record.

In addition to the serial notes comprising the major [fol. 6347] part of the $5,017,543.80 shown on Line 7 in Column M of Exhibit No. 48, Page 2, there was an unextinguished balance of $17,543.80 on a leasehold purchase obligation to J. T. Sneed, Jr., and Elizabeth Sneed Poole, the principal amount of which was $62,000 which concludes the remarks the witness has with respect to this item.

Q. Yes. Are these notes explained in some detail on Pages 75 and 76 of Exhibit No. 145 for identification under the part or item numbered 3, commencing on the lower half of Page 75?

A. They are.

Q. Turn your attention now, please, to Line 16 of this page we are discussing which is the account for "Taxes Accrued" which, according to Column M at June 30, 1941, amounted to $3,176,774.41.

In your direct testimony, you itemized, somewhat in detail at Page 868 of the transcript, certain State income taxes, Federal income taxes and excess profits taxes which were a part of the total which I have just stated and you indicated also that certain of these taxes were for the years 1938, 1939, 1940 and 1941 and, in response to a question of Respondent's counsel as to why there appeared in this account at June 30, 1941, taxes other than those for the year 1941, you replied as follows:

"Without being facetious, by reason of the Acts of [fol. 6348] State Legislature, principally", could you explain in somewhat more detail than that why there were outstanding amounts for taxes in the years 1938, 1939 and 1940?

A. Putting it as simply as possible, the time of accrual of the various types of taxes heretofore enumerated in the record at Page 867, et seq., does not coincide with the actual time of payment of such taxes, so that in any statement which Panhandle Eastern Pipe Line Company and its subsidiary companies may prepare at any given period, there will always be accrued but unpaid taxes representing periods not exactly coincident with the accounting period for which the report is prepared.

As an example, my remembrance is that in the State of Missouri, ad valorem taxes are assessed as of July 1. Perhaps I am wrong there to this extent: It may be that our return is due on July 1, that the assessment is made by the State Tax Commission sometime between July 1 and December 31 of each year, but the amount of such taxes is not due until the following December.

Likewise, accrued Federal income and excess profits taxes at any date prior to December 31 in the year in which any statement may be prepared will contain unpaid portions for, as you know, Federal income and excess profits taxes are generally paid on a quarterly basis.

Furthermore, the Federal capital stock taxes are paid [fol. 6349] on or about July 1 of each year and at any date other than on that date, there may be such taxes applicable to a prior year or to a subsequent period and the same general situation exists, to some degree, more or less with practically all the taxes that Panhandle Eastern Pipe Line Company or its subsidiary, Illinois Natural Gas Company, are confronted with.

Q. Does that complete your answer, Mr. Watkins?

A. It does not.

In addition to the condition governing such of the taxes to which the witness has made references, there is most always present in the affairs of any organization accrued but unsettled Federal income taxes of prior years.

Very few organizations are fortunate enough in being able to exactly determine the amount of their Federal taxes of whatever nature and find it necessary, in a great many instances, to carry those accruals for some substantial period until an agreement has been reached with the taxing authorities covering the final determination of such taxes.

If that explanation is satisfactory for your purposes, I believe the witness has no further statements to make.

Q. You stated, Mr. Watkins, that the Federal income taxes are paid by this company in quarterly divisions. Can you tell us when the first quarterly payment is normally made, that is, approximately when it is normally made?

A. I believe we have no choice in that matter, do we?

[fol. 6350] Q. I do not think so, but I just wanted the record to state what the date was.

A. I think the date is each March 15th, is it not?

Q. Yes.

A. And to the extent that the company has any taxable income, whether or not it has finally determined its return for the preceding year, it must make an estimate and pay a portion of the estimated amount of taxes at the time the tentative return is filed.

Q. Yes, and by analogy, of course, the second quarterly payment would be due and payable on June 15, would it not?

A. That is correct.

Q. Is it a correct conclusion to draw from your statement then, Mr. Watkins, that any reference to balances in this account for taxes for the years 1938 and 1939 represent amounts which were, as of June 30, 1941, in an indeterminate status? A. Yes, that is correct.

Q. In other words, they were amounts left over your actual payments but which might possibly be paid as a result of a final determination by the Bureau of Internal Revenue, the taxes required of you during those years?

A. Yes, that is correct. However, prior to the reduction of the original accrual to the amounts heretofore [fol. 6351] shown in the record with respect to the years 1938 and 1939, there may have been some adjustment made in the accrual by reason of an Examiner's Report if we found that our accrual had been excessive or if it had been insufficient.

Q. Yes.

A. I would not wish at this moment, without further investigation, to state that the $24,000-odd for 1938 and the $14,000-odd for 1939, Federal income tax accruals, had not been subjected to such adjustments although my belief is that they have not.

Q. And if upon a final determination it were decided that further payments in these amounts were not required for the years 1938 and 1939, would such amounts, according to the bookkeeping practices of the company, be transferred to earned surplus?

A. The company's bookkeeping practice does not recignize that adjustments of such an inconsequential nature should be made through earned surplus.

Our procedure which, if I am correctly informed, meets with the concurrence of the company's public independent auditors, is to route such adjustments through income rather than through surplus.

Now, if we had an item of some substantial nature as we may have in the year 1940, after our examination had been completed and we had arrived at some basis upon [fol. 6352] which the total taxes for that year were to be paid and there remained a substantial amount, we might give consideration to treating that as a surplus adjustment,

if, to do otherwise, it was of the nature to seriously distort income.

My remembrance is that the classification of accounts adopted by this Commission for use on and after January 1, 1940, recognizes as proper accounting procedure the treatment the witness has just described.

I have finished, sir.

Q. Yes, I was just pondering your answer, sir. I am not certain whether I got lost or not. Did you state, Mr. Watkins, specifically what accounts such adjustments would be made to? A. I did not.

Q. Would you do so, please?

A. May we proceed without repeating the previous statements?

Q. Yes, indeed.

A. And simply state that if the adjustments were to be made through income, it would very naturally be made to the account to which the prior accrual had been charged or credited.

If it were to be made to surplus, the credit or debit would be made to the appropriate surplus account as prescribed in the Power Commission's Classifiication of Accounts.

[fol. 6353] Q. Do I understand correctly that if it was made to surplus, it would not go through your income account? A. Not again, no.

Q. One further question on that subject. If such an adjustment was required, the normal effect, no matter how the bookkeeping transaction might be made, would be to increase the net income of the company to that extent for the particular year, would it not?

A. I am afraid we are at cross purposes there. If the credit were made to the expense account, it would increase the net earnings of the company, net operating revenue of the company for that particular year.

If it were made to surplus, it would simply increase or decrease the surplus account.

Now, if you choose to interpolate any increases or decreases in the surplus account itself within a given account-

ing period as a part of the net income for that period, then the answer to your question would be "yes".

Q. Yes. What I was getting at, simplified, was this, Mr. Watkins, without any attempt to confuse you or any other such thought: taxes are paid, are they not, out of gross income and such payments necessarily effect a reduction in the net income?

A. Well, without quarreling over the word "paid", that is correct. Actually, they are paid out of cash. They [fol. 6354] are recovered out of gross income.

Q. Of course, the lesser the amount of taxes paid, the greater the net income would be as a consequence thereof, is that a correct statement?

A. Yes, that is correct.

Q. Now, Mr. Watkins, on Page 3 of this Exhibit No. 48, there are certain notes to the balance sheet, the first of which refers to this item of taxes accrued states that: "Including Federal income taxes and excess profits taxes computed"—that is as of June 30, 1941—"without regard to special deductions resulting from the refinancing consummated during February, 1941, and without making provision for possible increase of rates or otherwise during 1941."

Have any computations envisaging the qualifications set forth in this note Number 1 been made since this Exhibit No. 48 was submitted?

A. There have been some such computations made.

Q. And would those computations of which you speak accurately or more accurately reflect the proper balance as of June 30, 1941?

A. The proper balance of the accrual account?

Q. Yes.

A. The computations were not made as of June 30, 1941. They were made in connection with Exhibit No. 145 and at September 30, 1941, appear in the income account consolidated on Page S-7 of that Exhibit under the general head- [fol. 6355] ing of "Charges in lieu of", Federal Taxes, $100,000; Federal Excess Profits Taxes, $487,000.

There is a reference with respect to the first of these two amounts in Note D on Page S-8 of the same exhibit.

Mr. Wheat: That is "D", is it not?

The Witness: That is correct.

There will be further adjustments of credit or rather charge in lieu of taxes during the year 1941 so that at December 31, 1941, there will have been given effect to the total adjustment resulting from this cause amounting to $823,881.49.

Mr. Wheat: May I ask a question. That will be the amount which you figure would have been payable annually if the company had not had the benefit for tax purposes of deduction for discount, premium and expense resulting from the refinancing of its long-term debt during 1941?

The Witness: That is correct, and which amount has been credited to the unamortized debt discount and expense prior to the charging of the unamortized balance of the debt discount and expense accounts to surplus in the manner described by this witness in the testimony given yesterday.

Mr. Wheat: Yes.

By Mr. Gorman:

Q. Do understand correctly that your last response [fol. 6356] to Mr. Wheat's inquiry indicates that the total income taxes payable for the year 1941 would have been $823,000-odd?

A. More than they actually will be because of the refinancing consummated in February, 1941.

Mr. Wheat: In that connection, I think possibly the witness ought to explain why there is that difference in taxes so that the record will be clear.

Mr. Gorman: I think that might well be done.

The Witness: Simplified, the reason is this: The regulations of the Internal Revenue Department and under the effective Revenue Acts, when long-term debt previously issued is disposed of, by refinancing or otherwise, require that the entire portion of the existing debt expense in connection with it must be taken as a deduction for Federal tax purposes in the year in which the refinancing is consummated.

Now, the $823,881.49 will be distributed in subsequent financial statements prepared by Panhandle Eastern Pipe Line Company for its internal purposes after this fashion —I am about to supply that information by months and if we do not need it, I will forego the explanation or I may give you—

By Mr. Gorman:

Q. (Interposing) I do not know that we would need that at all, Mr. Watkins.

* * * * * * * * * * *

[fol. 6357] Mr. Chamberlain: Mr. Watkins, do you have the ultimate division of the $823,000 as between Federal income taxes and the excess profits taxes?

The Witness: I do.

Mr. Chamberlain: What would those amounts be as of the end of the year?

The Witness: The amount applicable to Federal income taxes as of the end of the year 1941 will be $141,106.77 and the amount applicable to Federal excess profits taxes will be $682,774.72.

The sum of the two is the $823,881.49 concerning which we have been speaking.

By Mr. Gorman:

Q. Now, as I understand, Mr. Watkins, the taxes which you actually will be required to pay for the year 1941 will be some $823,881.49 less than they would have been otherwise is the adjustments had not been made which you have previously testified to, is that correct?

A. That is correct, if we are speaking of the actual taxes to be paid. If we are referring to the amounts that we have heretofore or may hereafter accrue for the year 1941, that amount will be subject, of course, to consideration as to any differences the Internal Revenue Department Examiner may disclose and we may agree to or disagree with.

[fol. 6358] Q. Yes, naturally so. Are you prepared to tell us what the Federal income tax will be for the year 1941 as you presently compute it and estimate it?

A. No, our books have not been completely closed yet.

Mr. Chamberlain: Have you made you accruals?

The Witness: Why, Mr. Chamberlain, since our books have not been closed, I have no preliminary figures with respect to any of the amounts at the year-end.

They will be available and will be shown in our Annual Report when released. As you may know and as Mr. Tuttle will verify, you do not arrive at your year-end figures without a good deal of clean-up work. Ours has not been completed.

Mr. Chamberlain: Don't you accrue by the month on those Federal taxes?

The Witness: That is not the point, sir. You asked me whether or not we have them for the end of the year and I stated we have not.

Mr. Chamberlain: What I intended to ask you for what amount you had accrued in the accounts up to the end of the year?

The Witness: We do not yet have our year-end figures. Now, if you care to observe the accruals at September 30, you will find them in Exhibit No. 145, a copy of which you have.

[fol. 6359] Further than that, there has been no information introduced in these proceedings with respect to the accruals and I do not have the accruals as at December 31, 1941.

By Mr. Gorman:

Q. Mr. Watkins, can you, by reference to Page S-7 and the notes and explanations which appear on Page S-8 of this Exhibit No. 145, indicate to us what the Federal income taxes would have been as you computed them at September 30, 1941, without the adjustment of debt discount and expense to which you have previously made reference?

A. Assuming we had no such deduction?

Q. Yes.

A. Would you please look at Page S-7 and note an amount under the heading "Charges in lieu of—Federal income taxes" of $100,000.

Will you further observe under a heading "Provision for income and excess profits taxes" opposite Federal in-

come—$1,202,000. At September 30, the accrual for such taxes, had there not been the deduction concerning which we have been speaking, would have been the sum of those two amounts or $1,302,000.

Will you also observe an amount opposite Federal Excess Profits Taxes under the heading, "Charges in lieu of—" amounting to $487,000 and, on the same page, under the general heading "Provision for income and excess [fol. 6360] profits taxes" opposite Federal excess profits taxes—$648,000.

The sum of those amounts would have been the accrual at September 30, 1941, for Federal excess profits taxes had there not been such deduction and the amount would have been $1,135,000.

On this assumption, the net taxable income, as estimated by the company, would have been the actual net taxable income were the company required to render a report of its net taxable income to Federal authorities and make such payment on the basis of the nine months ended September 30, 1941, and could have exactly and correctly estimated such tax.

Q. Now, on the basis of your recomputation, including the amortization of debt discount and expense, are the accruals which were set aside for taxes accrued as of September 30, 1941, and June 30, 1941, in excess of the taxes which the company will be ultimately called upon to pay, according to its present computations?

A. That is, reinstating the credit of $487,000 for charges in lieu of taxes or representing that portion of the $823,000-odd heretofore referred to as the total savings and taxes as a result of the refinancing consummated on February 3.

Q. Yes.

A. The total thus arrived at would be greater than the [fol. 6361] amount of the Federal income and excess profits taxes this company would have to pay were it necessary to render a report and make a settlement for such taxes as of September 30, 1941, or, for that matter, as of June 30, 1941, as well.

Q. Have the recomputations which you have made necessitated any adjustments in the account for taxes ac-

crued? What I am inquiring about, Mr. Watkins, is whether or not it has been necessary, by reason of your revised estimates and certain transactions on your books relating to amortiation of debt discount and expense, to transfer from your income and excess profits tax accrual account certain amounts previously accrued therein?

A. We have charged, by Journal Entry No. 10 74 entered in the month of October, an aggregate of $823,-881.49 to the Federal income and excess profits tax accrual accounts for the year 1941 and have credited such amounts to the appropriate unamortized debt discount and expense accounts.

That credit having been made prior to the charging of the unamortized debt discount and expense to surplus as discussed in yesterday's proceedings, there was also an entry made through the Journal Entry 10 75 in October, 1941, charging to two new accounts created by the company under the No. 507-1 entitled "Charges in lieu of Federal income taxes" and "Charges in lieu of Federal excess profits taxes", with a corresponding concurrent credit to Account 507, "Taxes Federal Income" and [fol. 6362] Account 507, "Taxes Federal excess profits taxes", the total of $823,881.49; this amount having been divided between the debit and credit accounts in the order stated in this testimony in the amount of $141,106.77 and $682,774.72, respectively.

Of these latter amounts, the journal entry shows their application to the period from January 1 to September 30, 1941, and for the period October 1 to December 31, 1941.

Have you any interest in that segregation?

Q. I might ask you this question which I believe would obviate any answer such as you have just suggested and that is whether or not such entries, as you just mentioned, would reflect any change in the income accounts for the first six months of 1941 and when I say "Income accounts" I mean any change in the net income.

A. They will not.

Q. That is true not only of June 30, 1941, but also of September 30, 1941?

A. That is correct. So far as the net income of the operation for the company and its subsidiary, Illinois

Natural Gas Company, is concerned at those periods, the effect of these entries was simply to lift the $823,000 from the tax expense accounts to expense accounts which we have characterized as "Charges in lieu of Federal income and excess profits taxes" and made no change whatever in the net income.

[fol. 6363] Q. That was my understanding and, with that understanding, of course, I do not believe any further explanation is necessary.

Now, Mr. Watkins, referring to this Line 16 for taxes accrued, with the exception of the amounts which you have indicated in your direct testimony as being attributable to the years 1938, 1939, 1940 and 1941, due the balances shown at December 31, for each of the years on this line reflect taxes actually paid or do they reflect the accruals in this account based upon estimates of taxes to be paid?

A. For the most part, the amounts shown on this line for the end of each of the respective periods covered by this exhibit represent the best possible estimate the company has been able to make and when I say "company", I include the subsidiary, of the amount of taxes it will eventually have to pay.

There were, however, and are in each of the periods, certain specific taxes that were determined during that period and, to that extent, however much or however little such amounts may be, they are not pure accruals.

As you know, Social Security taxes clear themselves within an annual accounting period. There are certain gross sales taxes in some of the States in which we operate, certain gross production taxes and certain other taxes that will find their way into our accruals in one [fol. 6364] month and are paid in the next month.

Q. Yes, your statement is that, with the exception of those taxes which are capable of definite ascertainment during the periods taxable, the balance represent accruals based upon estimates of taxes to be paid rather than actual payments subsequently made?

A. That is correct. However, we may—before passing from this subject—be assured that for the most part our acutal taxes have been somewhat in excess of the accruals.

Q. Could you, Mr. Watkins, for the year 1936 and the years following, furnish a statement of the actual taxes paid to date for those respective years?

A. Such a statement could be furnished. It would be difficult to match the payments made in those years with the accruals in those years because of the lag or overlapping of the period of accrual and dates of payment.

When I made the statement a moment ago that, for the most part, the company's accruals have been slightly less than its payments, there was, in the year 1937, a situation such as that which we have described here this afternoon wherein the company had the benefit of certain deductions as a result of the financing operation carried out in that year.

There was likewise, I believe, a slightly excessive accrual in both the Federal income and State income taxes in the [fol. 6365] year 1936. That was the first year in which we had Federal taxes to worry about. Prior to that time, we had losses, both from a corporate standpoint and from a tax standpoint.

There is a situation in connection with the year 1940 which may involve something on the order of $200,000. This arose because of the fact that the income tax laws were changed in that year or rather were changed in the year 1941 and our accruals for the year 1940 were on what is known as the invested capital method rather than the income method.

After the change of the law in early 1941, it appeared we might have some advantage by using the income method and, as far as we now know, although the year 1940 has not been examined by the Federal authorities, there will be an excessive accrual for that year.

Now, to go a bit farther with respect to the excessive accruals and to perhaps make a little speed, may I call your attention to an amount of $624,800.94 appearing on Line 36 in Column M on Page 2 of Exhibit 48 and supply a statement showing the amounts that constitute that reserve?

Q. If you will, please.

A. $76,580.60 of such reserve represents a transfer of the balance remaining in Federal income tax accrual account for the year 1936.

Now, said differently, there was $76,580.60 of accrued taxes for the year 1936 not used for that purpose. In that [fol. 6366] same year, 1936, there was $20,220.34 of the accrual for the State income taxes not used.

In the year 1936—

Q. (Interposing) Just a minute, Mr. Watkins, may I interrupt.

That statement tends to indicate, does it not, that the accruals were approximately $125,000 in excess of the actual taxes paid, is that correct?

A. If I may finish, I believe I will be able to answer the question—

Q. (Interposing) I am sorry.

A. (Continuing)—answer the question with respect to the whole amount.

There is a further transfer with regard to accrued but unpaid taxes in the year 1937 as a result of the financing operation carried out in that year of $492,000 and an addition of $36,000 because of State income taxes accrued for the year 1937 not needed.

Now, the entire $624,800.94 does represent taxes accrued but not paid. It is being carried on the company's books in general reserve to be used with regard to any demands that may be made on the company hereafter for undetermined or disputed income taxes.

It is the reserve of the nature, naturally, that the Board of Directors or the management of Panhandle Eastern [fol. 6367] Pipe Line Company or of Illinois Natural, if some of this amount belonged to Illinois Natural, can be returned to surplus and used for the general purpose that surplus is customarily used for.

Whether that will be done or not, is something the witness cannot say at this time.

Now, the transfers to this account of other reserves that you are speaking of, were those transfers from the taxes accrued account?

A. That is correct.

Q. Are the figures shown at Line 16 for the taxes accrued the balances remaining from the total accruals after such transfers have been made in the respective years to which you have previously testified?

The Witness: May I have the question, please?

(Whereupon, the pending question was read by the reporter.)

The Witness: Save for the amount $36,002.66 shown on Line 36 in Columns B, C, D and E, the amount shown on this line on Page 2 of Exhibit No. 48 represent amount transferred from tax accruals because of accrued but unpaid Federal and State income taxes during the years 1936 and 1937.

The transfers may not have actually been made exactly in those years, the returns not having been completely examined by the Federal authorities cause delay in the transfer.

One observes in Column I, that only $96,000 was trans- [fol. 6368] ferred in the year 1937 whereas this amount increased at December 31, 1938, to $424,800.94 as shown in Column J on Line 36 and, at the close of the year 1939, had been built up by an additional $200,000 so that at the end of the year, the total became $624,400.94 and continued at this amount to June 30, 1941, and to this very date, for that matter.

Q. And there have been no payments, have there, Mr. Watkins, from this other reserve account since 1936 or charges to this account which would tend to diminish the amount remaining there?

A. There were never any payments from this account.

Q. Yes.

A. I stated that rather positively. That is my remembrance at the moment.

Q. I think that is borne out by reference to your Registration Statements which indicate that the amounts set aside in the particular years which add up to the total shown at June 30, 1941—I am not testifying—

Mr. Wheat: (Interposing) That amount of $36,002.66 shown on the earlier years, that had nothing to do with what you are talking about, did it?

The Witness: That had nothing to do with that, no.

* * * * * * * *

[fol. 6370] By Mr. Gorman:

Q. Mr. Watkins, turning our attention to the reserve for depreciation of gas plant, you have heretofore in your direct testimony stated the rates which were applied to the gas plant account for the accruals for depreciation, allowance for the various years from 1931 through 1940. An examination of such rates indicates a considerable variance over a period of years. Can you tell us, somewhat generally, of course, how the rates were arrived at during the years I have just mentioned?

A. Will the record bear out the fact that rates were stated for all of those years?

Q. I think that it will. I will check it.

Yes, I think if you will turn to page 884 of the transcript you will find that a reading was made from Registration Statement No. 2-2867 before the Securities and Exchange Commission effective March 29, 1937, which set forth the rates for the years 1931 through 1936, and at page 887, there is a reference to another Registration Statement which sets forth rates for the years 1938, 1939, and 1940.

A. I believe, sir, that is a statement showing the percentages which the provision for the years 1938, 1939, and 1940 was equal rather than the rate used. Is that correct?

[fol. 6371] Q. I believe that is so stated. Is that true in each of the years that I have mentioned?

A. No, only for the years stated on page 887.

Q. That is 1938, 1939, and 1940?

A. That is correct.

Q. And for the other years a definite rate was determined and applied to the plant accounts for the years in question. Is that correct?

A. Yes, that is correct, and is so shown on page 884 of the transcript.

Q. But taking up, first, the years 1931 through 1936, when definite rates were determined, can you indicate to us how such rates were determined?

A. You may well imagine that in a situation such as that maintained by the companies from an earnings standpoint through the earlier years of its existence, the ques-

tion of the provision for depreciation, depletion and otherwise might not carry with it the prominence that such consideration would receive when the facilities began to be operated more nearly to their capacity. The rates used in the earlier years were recognized by the company officer or company officers as being inadequate. There was no great reason, as we saw it at that time, to provide provisions and, as a matter of fact, we lacked a good deal of [fol. 6372] information upon which to predicate what might be a reasonable provision over the probable life of the properties for this purpose, and it was not until around the year 1936 and, as a matter of fact, at about the time when Mr. Creveling became our president, that real consideration of this problem took very definite form.

Among the first things which Mr. Creveling was interested in when he came with the organization and among the things that the present witness had awaiting some determination was this particular question.

Now, I do not mean to say that over the previous years we had not been thinking something about what we would eventually use and when we would begin to use it.

By reference to Exhibit No. 49, it will be noticed that the amounts deducted from gross income beginning with the year 1936 for this purpose, including, shall we say, the amounts shown on Lines 10, 11, 12, 13, 14, and 15 in Columns F, G, H, I, J, L, and M of page 2 of that exhibit, were increased.

Since Column L is an average of the period for the years 1932 to 1940, it should be stricken from the previous statement being merely the result of a stipulated period and not particularly applicable to an accounting period.

Our consideration in the year 1936 was such as to cause [fol. 6373] us to arrive at what seemed at that time, and as far as we could gaze into the future, a proper basis upon which our depreciation accruals should be predicated. This question, as you know, is not one left entirely to the officers or to management and must, in most cases, be acted upon by the Board of Directors. Those of us connected with the organization giving consideration to this matter felt it appropriate to have some independent approach made to the question of the amount that should be recommended to

the Board for this purpose and the services of Mr. P. MacDonald Biddison were engaged for that purpose. Mr. Biddison, as you know, has been a witness in these proceedings. His aproach was entirely different, as far as I know, from any consideration theretofore given or being given by the company at that time. We did not confer with him as to what method we had in mind, what conclusions we had tentatively or finally reached, but simply requested that he make a determination as to what should be an approximate annual amount and whether or not the reserves accrued to that date were adequate.

There were at least two of the officers of Panhandle Eastern Pipe Line Company somewhat astonished at the result of Mr. Biddison's consideration. My remembrance is that his conclusions were within, perhaps, one-tenth of one per cent of the amounts independently determined by the com- [fol. 6374] pany, that is to say, the rate resulting from the annual amount of Mr. Biddison's determination was within, say, one-tenth of one per cent of the resultant rate determined by the management.

Mr. Culton: That is in dollars you are within that percentage of each other?

The Witness: Applied to the base upon which they were determined, yes, sir.

Now, there has been introduced in these proceedings as Exhibit No. 108, a letter from Mr. Biddison dated December 13, 1937, which speaks for itself, and, if I interpret it correctly and if I did at that time, it was more or less a green light to the company, in Mr. Biddison's opinion, to follow on the method we had, without his assistance previously arrived at.

Our independent public accountants have had, very naturally, some interest in this matter, and beginning with the year 1937 or the year 1938 their certificates used in connection with the company's annual reports have been of such nature that the auditors were satisfied that the annual accrual and that the provision to date was reasonably adequate.

Now, as a result of all this study by both the company officials and by the independent engineer and by the consid-

eration of the accountants, and I mean independent public [fol. 6375] accountants, although they made no specific study other than to satisfy themselves, as accountants usually do, that the proper basis was being followed and that the provision was within reasonable bounds of what it should be, and that the amounts at the end of the year were reasonably adequate and not excessive and of such nature that it was unnecessary for them to qualify their certificates, the amounts shown were provided.

At page 887 of the record, particularly on Line 14 thereof, the provision for this purpose,—and in using the word "provision" here the witness intends to take in the reserve for depreciation, depletion and amortization and all of such reserves,—was equal to 2.98 per cent, 3.2 per cent and 3.16 per cent of the Consolidated Property, Plant and Equipment Accounts at the beginning of the respective years.

I believe the equivalent amounts for the year 1941 and for the year 1942, if no change is made in the plan of accrual, will be somewhere on the order of 3.2 per cent.

I believe it was yesterday that we took into the record a portion of Note A to the Income Account of Panhandle Eastern Pipe Line Company and subsidiary companies included as a part of Registration No. 2-4919. Need I describe that further?

By Mr. Gorman:

[fol. 6376] Q. I believe not. I think that is sufficient.

That appears, does it not, at page S-8 of the Registration Statement to which you have just made reference?

Mr. Wheat: Exhibit 145, you refer to?

Mr. Gorman: No, I believe the witness is referring to a document which is not an exhibit.

The Witness: Yes, it appears on page S-8 and likewise, is substantially repeated again on page—well, it was not repeated. As a matter of fact, by reference to periods here today were to the same registration statement.

Mr. Wheat: Exhibit 145?

The Witness: That is correct.

[fol. 6377] By Mr. Gorman:

Q. Now, as I understand your statement, Mr. Watkins, for the years 1937, 1938, 1939, 1940, and, I believe you also mentioned 1941, the management submitted to the Board of Directors an amount of dollars, which should be, in their opinion, that is, the management's opinion set aside for depreciation, depletion and amortization based upon the Gas Plant Account, as of the beginning of each of these years. Is that correct?

A. The amounts were not necessarily based upon the Gas Plant at the beginning of each of the years. The amounts gave consideration to possible increases in Gas Plant during the year for which the recommendation was being made and were intended to provide under such circumstances substantially the equivalent rate that resulted from the determinations made by the management and made by the independent consulting engineer back in the year 1936.

Q. Yes, and I assume, naturally, that the objective in considering expenditures to be anticipated during the [fol. 6378] current year was for the purpose of giving recognition to the average balance in this account during that year? A. On the order of that, yes.

Q. And was my statement that this recommendation was in the form of an amount of dollars correct rather than a specified percentage of individual items of Plant Account?

A. Yes. We made no submission to the Board at any time of any specific rates applicable to any portion of the Plant Account other than to perhaps state that there was a provision in the Certificate of Incorporation which made necessary the amortization each year of an amount carried on the company's books as gas sales and purchase contracts, being the equivalent of twelve times $24,419.05; that there were other gas sales and purchase contracts being amortized on the basis of their respective lives; that depletion would be based on gas withdrawn, and that the difference would represent the amount applicable to all of the rest of the properties.

The amounts determined gave consideration, as the witness has previously testified and as the registration statements to which certain reference has been made in this and

yesterday's proceedings show, to the necessity for an amount each year representing amortization as distinguished from amortization of the gas sales and purchase [fol. 6379] contracts.

Q. I do not recall, Mr. Watkins, that in your statement a short while ago you indicated more or less definitely the manner of determining the percentages which were applied during the years 1931 through 1936. You did discuss them, but I do not believe that you stated how those percentages were determined. Do you recall at the present time?

A. Well, as a matter of fact, I do not believe I know because in some of those years when I was assistant secretary and assistant treasurer of the company, I was not present at some of the Board meetings at which the amounts were discussed and decided upon. I learned of the result of such discussion after the facts had been accomplished.

Q. So your present answer is that you have no recollection or knowledge of the manner in which those percentages were determined?

A. Oh, I might go back over the records for those years and be able to state that it appeared from the information available to me at this time that this was about the method or manner of approach.

Q. Well, I am speaking of your knowledge right at this instance without consultation of company records.

A. Well, I should have to say, sir, that I have no [fol. 6380] very great knowledge as to the method used in their determination. I believe I have previously said, however, that they did impress me as being inadequate.

Mr. Wheat: You are referring now to the percentages which you read into the record at page 884, are you?

The Witness: I am referring now, Mr. Wheat, to not only the percentages used in the years prior to 1936, if percentages were used in those years, but, likewise, to the amounts resulting from the use of any such percentages in any such of those years.

* * * * * * * * * * * *

By Mr. Gorman:

Q. Your answer was, was it not, to my previous question that the amounts set aside in 1937, 1938 and 1939,

and 1940, as reflected in the Income Account of Exhibit No. 49, were determinations made by the management and confirmed by an independent consulting engineer, namely, Mr. P. MacDonald Biddison?

A. The amounts now shown in this income statement or rather this Exhibit are the result of recommendations [fol. 6381] made to the Board of Directors and of authorization by the Board of the establishment of certain amounts for annual provision, all of which was predicated upon and the direct result of studies made by the management and the independent engineer.

Now, a moment ago you asked the question as to what the witness' view was with respect to the provisions for the year 1931 or, rather, for the nine months of 1931 up to and including 1936, and Mr. Wheat tied it up with previous testimony by this witness on page No. 884 of the record. In connection with that I should like to draw attention to the fact that a few moments ago in discussing this question the statement was made, notwithstanding the witness' view with respect to those years, that the independent engineer's first determination proved that the reserve made up to that time was adequate.

* * * * * * * *

My personal view of those particular years, taken as such, is that the provision for the years, if we consider it on a basis of the operation of the facilities, somewhat on the basis of the manner in which they might have been intended to operate, would have been inadequate.

Q. That is the years through and including 1936, as [fol. 6382] you testified?

A. Not necessarily including 1936, because in 1936—no, I am wrong, it was not until 1937 that we substantially increased the provision.

Q. So it did include 1936? A. Yes, it did.

Q. And that opinion, of course, is based upon your more recent experience from and after 1936 and studies made by the management from that date?

A. Just how do you mean that, sir?

Q. Well, I mean primarily that you have gained a great amount of information and knowledge on this subject which led you to the opinion that the provision in the

original years was inadequate. I am not attempting to confuse you, I am just—

A. (Interposing) Well, I want to get it straight, so that I can answer it properly. I do not believe my opinion is based upon anything that I may have learned and I will admit that I have learned considerable in late years,—I should hope I never stop doing so,—but, rather, as I recall upon the condition existing in those years.

Now, as I have said before, possibly twice, the independent engineer's conclusion,—and that was one of the reasons why we employed him,—was that the total amount of the provision up to and including, shall we say, the [fol. 6383] year 1937 was adequate and that the amount that management was about to recommend to the Board for the ensuing year was, likewise, adequate.

Now that condition, as far as I know, remains unchanged for all the years since.

As I have stated, our public accounting firm has not found it necessary to make any exceptions in their certificate with respect to this particular matter subsequent to that time.

Q. Yes. When you use the term "adequate" in connection with the accumulated reserves as of the particular years in referring to the letters of this independent engineer, which are Exhibits 108 to 111, both inclusive, you mean, do you not, that they were not only adequate provisions, but they were not excessive amounts?

A. No, Mr. Gorman, we are talking, I hope, about records and not about whether or not these amounts are adequate for rate purposes. I cannot qualify to express an informed opinion with respect to the rate side of it. We have considered them and wherein this witness has referred to them as being adequate and where, in my judgment, Mr. Biddison has referred to them as being adequate and so far as the public accounting firm is concerned we are dealing entirely with the provision made per books and without respect whatever to a rate proceeding.

[fol. 6384] Mr. Culton: Or, to actual accrued depreciation observed?

The Witness: Our actual sustained depreciation, if you please, whether or not our guess over the period as to which we shall recover our amortization is correct.

Our philosophy, I believe, could be summed up this way, that over the life of the properties devoted to the service that Panhandle Eastern Pipe Line Company's properties are, there must be recovered through the income that is earned a certain amount of depreciation. We hope we have made an estimate which will produce desired results.

By Mr. Gorman:

Q. Of course, the accruals which are set aside each year include not only depreciation, but amortization, do they not?

A. Well, they include in our minds some specific amortization of certain specific things.

Q. Yes.

A. But the other amortization to which this witness is making reference is that which must in the very nature of these properties be inexorably tied up with any determination as to what annual provision is made for books or for any other purpose, for that matter, because we are dealing with a wasting asset. We are in a mining industry. We do not know how long our reserves will last. We have [fol. 6385] some estimates, certainly. Our facilities may be worth something, we may be able to use them for some other purpose after those reserves are gone. We do not know so that we cannot wait until the time approaches when that condition is evidenced and then come to the Federal Power Commission, or any other regulatory body under which we may be operating, and say that we have to collect from the consumers this year blank millions of dollars to take care of this particular thing that we see at this particular moment.

Q. May I qualify my previous question, then, and ask whether or not your opinion and, also, your conclusion as drawn from the statements or letters submitted by Mr. Biddison to the management of the company, that the annual accruals in these specific years referred to were adequate and that the accrued amount in such years was ade

quate, meant to you that such accruals and such accrued amounts were not only adequate, but were not excessive when considered as amounts provided for depreciation and amortization of your property?

A. For the company's internal purposes and for the purposes of these records, my answer is yes.

Q. Yes.

A. For all other purposes I have no answer.

Q. Mr. Watkins, in your opinion, do the same forces and [fol. 6386] reasons that determine the amount of the annual accrual also determine the total amount of accruals to date in the reserve accounts?

A. I do not believe I understand just what you mean.

Q. Well, let me put it this way: If your annual accruals are determined properly, the amount resulting from such accruals must necessarily have been determined properly?

A. Well, I do not believe I can—

Q. (Interposing) Well, that is so simple it sounds confusing, I imagine.

A. We have a situation here, as I see it, where the company has used reasonable, perhaps more than reasonable prudence in determining for its internal use and purposes what should be the amount set aside annually for this purpose and whether or not when those amounts have beet set aside the result, after having deducted any retirements made prior thereto, is reasonably adequate for the purpose.

Now we believe that to be the condition. Whether the year 1937 or the year 1931 was all haywire, whether it was 1,000 per cent high or 7 per cent low may, in this witness' estimation, ~~be of little consequence~~. In looking at the results of what has happened in restrospect, we are dealing [fol. 6387] with a certain condition that existed at June 30, 1941. There are exhibits here that show what happened in the various accounting periods prior to that time. There have been a multiplicity of things that might now, as we look back at the results of some of those years, change them. I should not want to state categorically whether the year 1938 accrual picked up any deficiency in any prior year or provided any excess for any subsequent year.

Again, I am speaking entirely from the standpoint of the company's internal needs, and not with respect to any rate proceedings or otherwise.

Q. Yes. Of course, we are all aware of the fact that the company has made a determination in previous years of the amount which it considers necessary to set aside in a reserve account during that year for depreciation and amortization. You have so testified, of course, have you not?

A. Well, I have not only testified that there have been such amounts determined, but I have presented an exhibit showing what is the result of such determination. That exhibit is No. 49.

Q. Yes. And has the company and the management of the company,—when I say "company", of course, it must necessarily be the management and the Board of [fol. 6388] Directors,—also determined that the accrued amounts remaining in these accounts to date represent a proper reserve for depreciation and amortization?

A. For what purpose?

Q. Well, for the purpose of these exhibits which you have put in here showing the condition of the company on its books and records.

A. The Board of Directors have made no determination whatever, as far as this witness knows, with respect to the accumulated accruals at any particular time, nor has the Board of Directors made any determination with respect to any of the exhibits submitted in these proceedings by any of the witnesses, as far as I know, that have appeared, but the Board of Directors has determined and authorized certain annual amounts and the officers of the company have carried out the Board's determination. We may have squeezed a little extra once in a while, we may have failed to take quite as much as the Board determined, but, generally speaking, the amounts provided in each year have been most comparable with the Board's determination for that particular year.

If that is not responsive to your question, will you please ask me another one?

Q. Well, I was just examining the response in my own mind. Of course, the Board of Directors' determina-[fol. 6389] tion in each year of the amount to be set aside

in the reserve accounts for that particular year represents, does it not, the opinion of the Board of Directors?

A. It represents their action, certainly. I may inform you, sir, that the Board of Directors is cognizant of the fact that the company has received these annual letters from an independent engineer.

Q. Yes.

A. The matter is presented to the Board when the annual accrual is suggested to the Board; the amount of it. The Board is informed that it is in concurrence with the suggestion of the independent engineer. The Board then, very naturally, has the right to accept it or reject it.

Q. Well, in these letters to which we have been making reference, Exhibits 108 to 111, the consulting engineer has stated that the reserves at the end of the years which he has studied are reasonable reserves based on the age and estimated life of the property. Of course, he is referring there, is he not, to the accrued reserves as of the date mentioned?

A. Would he not have to be?

Q. I say, is he not there making such reference?

A. It seems to me that he is.

Q. Yes. Well, has the management, also, made a [fol. 6390] similar study, resulting in an opinion on this subject?

A. Based on the age and estimated life, no. The management has no mortality tables available to it with respect to this class of property. Long-distance transmission lines are relatively new. It may very well be that because the greater amount of their retirements to date has been functional rather than physical we may suddenly awake one of these times and find that the aggregate of the accruals, less the amounts charged to the accruals up to that particular date certain, is astonishingly disproportionate to what we might require. We might even find that it is too much. Time alone will tell us that.

Q. Yes, I think that is true. Of course, you are merely basing your estimates on your best present information?

A. For internal company purposes.

Q. That is right, the accuracy of which can only be borne out and proved by future experience?

A. Is that a question?

Q. Yes. A. I think that is correct.

Q. Can you tell us, Mr. Watkins, what amortization period the management uses in determining the amounts to be set aside each year?

[fol. 6391] A. Amortization of what?

Q. Of plant property, speaking now, still, of the—

A. (Interposing) Well, let's put it this way, Mr. Gorman: We do actually amortize a portion of the investment of the company over specific periods, that is, the gas sales and purchase contracts. We, also, have some investment in unoperated leaseholds.

Q. Yes, if I may interrupt, Mr. Watkins, I wanted to confine this question to the account for the reserve for depreciation of gas plant as indicated at Lines 28 and 29 of page 2 of Exhibit No. 48, as distinguished from the other reserves.

A. You understand, of course, that in the preparation of the exhibits introduced through this witness, we tried to relate all of the facts shown by those exhibits to the classification of accounts adopted by the Federal Power Commission and made effective January 1, 1940, notwithstanding the fact that in some of the prior years our accounts had not been exactly in conformity with that classification and, further, that the reclassification required as a result of the adoption of the classification of accounts prescribed by the Federal Power Commission had not been completed.

You are also aware, I am sure, that there must be some determination of the adequacy of the depreciation reserve [fol. 6392] and, further, that that information is available to the company and to the Commission itself, but not necessarily part of the formal records. The reserve accumulated at January 1, 1940, and annually thereafter must be segregated as to production, transmission, distribution, general property, and so on.

Now, in the determination made by the management, concurred in by the consulting engineer who was independent and approached the problem without any knowledge whatever of the company's conclusions, and subsequently recommended to the Board of Directors, we had an objective of a rate, an effective rate or a percentage that would represent the result of the combined total we were going to ask the Board to act upon of around three per cent. Three per cent represented the total property subject to either amor-

tization, depreciation or any other cost. If that were translated to a life span and if the corporation ultimately recovers through earnings 100 per cent of its investment, it is pure mathematics to see that it would be about 33 years, but actually we did not determine 33 years because, as this witness has testified, there are so many things that we yet do not know about what the life span of these properties will be that we may have to change our views next year, maybe five years from now, perhaps at the very end of the life of the properties.

[fol. 6393] Does that help any?

Q. Yes, it does, considerably. But do I understand correctly that in providing an amount for amortization you do not, necessarily, predetermine a period for such amortization? A. And depreciation.

Q. And depreciation?

A. No, we do not. That is a life span.

Q. That is right.

A. We determine a period for the amount we suggest which is one year.

Q. And the fact that in late years you have been setting aside each year an amount equal, approximately, to three per cent of the Gas Plant Account, despite the fact that it, if carried continuously on throughout the succeeding years, would amortize and depreciate the property within a period of $33\frac{1}{3}$ years, does not carry any connotation that in arriving at such three per cent you did, in fact, consider a life span of $33\frac{1}{3}$ years?

A. It does not. If I may correct your statement, sir, we did not arrive at three per cent as such. We found three per cent when we were finished with our conclusions.

Q. I intended to say equal to three per cent, but I did not. A. Pardon me.

[fol. 6394] Q. Is it correct, then, to draw the conclusion from your statements that in providing an annual accrual for depreciation and depletion you give no consideration to the estimated life of the reserves presently available to the Panhandle Company?

A. It would not be proper to say that, no.

Q. Why not, may I ask?

A. We are conscious, always, of the probability that the reserves available to Panhandle Eastern Pipe Line Com-

pany's facilities may be overestimated. It may not last anything like as long as our estimates show that they probably will last. There could be some act of God that none of us know anything about that would completely destroy them. I do not know anything about geology, but something of that sort might happen. There might be some change in the utilization of natural gas that would make it a product that nobody would want. There might be the introduction of sulphur, a sulphur content in our natural gas such that it could not be used.

Now, whether that is possible or not, I do not know. I cite these things to show that we are naturally conscious that if one determines the probable life of a facility at any particular date certain, they must be conscious of the things, the very nature of which can make that estimate erroneous the next instant.

[fol. 6395] Certainly, we gave consideration to the possible length of the life of the properties. That did not necessarily mean, however, for internal purposes that we acted upon the estimates that we might have had at that time as to reserves.

We, also, had in mind the possible rate at which we were going to withdraw those reserves. We have in mind and have constantly in mind how we were going to develop our facilities, where we were going to sell our products, and a very wide variety of things that must be considered in approaching a matter as important as the determination of a provision for depreciation for internal, and no other purposes.

Q. What do you mean by "no other purposes", as distinguished from "internal"?

A. Well, sir, I am simply trying to say to you that I am in no wise trying to testify to depreciation to be or not be included in a rate proceeding.

Q. Well, I gather the impression, from your last statement, Mr. Watkins, that your company and the management thereof, in fixing an annual accrual, takes cognizance of the fact that the operations of the company are dependent upon a wasting asset, but that in fixing such annual accruals they do not give definite expression or weight to any particular span of years which these reserves will

[fol. 6396] last in the opinion of any expert geologist or other competent experts who undertake such estimations?

A. That strikes me as a fair statement of the situation, except that each of us approaching this subject very naturally have in the back of our minds something with respect to the probable life span of the properties and the reserves.

Q. But you and the others who participate in the management of this company have not looked upon any particular figure as representing the probable life of your reserves?

A. No, Mr. Gorman. We would like to be flexible in such matters. It would be improper, it seems to me, and highly so, for the present management of Panhandle Eastern or the management of Panhandle Eastern three years hence, or the management of Panhandle Eastern back in 1930 to have signed a blank check here for the company that was so hide-bound that attention could not be given to changing conditions.

It is not only true with respect to the depreciation reserve, but everything that we do in connection with the company.

Q. Yes. Is it your opinion and, if you know, is it also the opinion of others who participate in the management of this company, that for internal purposes, as you have [fol. 6397] expressed it, your accruals to date are adequate?

A. Speaking entirely for myself they appear to be and as far as my memory goes to any observations that may have been made in my presence by others, I think the same thing would be true. There has been some attitude expressd here and there that perhaps some of these days the Internal Revenue Department, for instance, will require us to give expression on the books to the same amount we seek as a deduction for income tax purposes. There have been many discussions concerning a thing of this sort. One just does not catalog in their mind every viewpoint expressed, but I think you have stated it fairly correctly.

Q. Now, in determining in your own mind that this accrued amount is adequate and not excessive, were you guided by the same factors and did you consider the same things which you take into consideration each year in de-

termining the amount of the accrual for that particular year?

A. There is no question but that the consideration given to this question each time it has been considered has been the result of a sincere effort on the part of the individuals involved in such consideration to take into account all of the factors present at that time, whether they be factors present in other considerations or whether they be factors that [fol. 6398] may never be present again.

Is that understandable?

Q. I think so. That is true in considering both the amount accrued, as well as the annual accrual at the time of consideration, of course? A. I think so.

Q. Yes. Now, Mr. Watkins, you made reference a short while ago to page S-8 of Exhibit No. 145, for identification, to certain statements contained therein to the effect that the Articles of Incorporation of this company require it to set aside certain amounts annually for the amortization of gas sales and purchase contracts. I notice on this same page that Note A refers t. certain provisions of the Articles of Incorporation, as amended, and requires certain provisions to be made for depletion, amortization and depreciation of property, plant and equipment prior to the distribution of dividends. Is that correct?

A. There is a statement on page 8 of that general nature.

Q. Yes. Now, you have undertaken in this paragraph A to state certain amounts which, on the basis of the provisions of the Articles of Incorporation, as amended, would have been provided for the years 1938, 1939, and 1940, and the first nine months of 1941. Those amounts and those computations have no direct relationship, do they, to the [fol. 6399] annual accruals which are set aside in a reserve for depreciation of gas, gas plant, shown at Lines 28 and 29 of page 2 of Exhibit No. 48.

A. No, those amounts are the result of a computation based on one-third of one per cent per month as stipulated in the Certificate of Incorporation, as amended, to determine to what extent the dividends may be paid out of surplus in accordance with the provisions of the Certificate of Incorporation. We considered them as restrictions of surplus with respect to dividends.

Q. Yes, and only with respect to dividends?

A. I think that is correct. And if you have any interest in the amount of such restrictions at September 30, 1941, June 30, 1941, or any other date, the witness will attempt to supply it. It is available for June 30, 1941, included, I believe, as a part of one of the exhibits. The witness can supply it for September 30, 1941.

There is a further and greater restriction in the mortgage and deed of trust dated November 1, 1940, which is on the order of $4,113,000, so that, in effect, the restriction, as provided by the certificate of incorporation, does not come into play until it accumulates an amount in excess of the restriction provided by the mortgage and deed of trust.

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[fol. 6403] Leith V. Watkins, resumed the stand and testified further as follows:

Cross-Examination (Resumed).

By Mr. Gorman:

Q. Mr. Watkins, at the time of recess yesterday afternoon we were discussing the account for reserve for depreciation of gas plant as shown as Lines 28 and 29 of page 2 of Exhibit 48. This reserve represents, does it not, those annual accruals which were shown at Line 10, account entitled "Depreciation Under Operating Revenue Deductions (Including Amortization)" on page 1 of Exhibit 49?

A. You mean it shows the residue?

Q. Yes, that is right.

A. (Continuing) Of the accruals made over the period as shown by the point specified in your question, that is correct.

Q. And accurately speaking, this reserve for depreciation of gas plant includes a provision for amortization, does it not?

A. Yes, I believe we covered that rather fully yesterday. We must not lose sight of the fact that it includes [fol. 6404] amortization with respect to gas sales, and purchase contracts and, also, an element of amortization with regard to the physical properties themselves.

Q. Yes.

My point was merely for clarifying the title which is shown in Exhibit 48, which merely refers to depreciation.

A. I believe the company is not necessarily responsible for that title.

Q. You mean that that is the title which is contained in the Commission's uniform system of accounts?

A. That is correct, and the total amounts shown in the various columns on page 2 of Exhibit No. 48 on Line 29 are the amounts or aggregate amounts of the reserves of any class the company might have had on its books at any of these periods, even though they were not specifically designated as "Reserve For Depreciation of Gas Plant."

Q. Yes. I believe you indicated, did you not, in your testimony of yesterday, that you were one of the officials of the company who assisted in the determination of the annual accruals to be set aside for this reserve each year?

A. My statements were not that definite with respect to the entire period. You will recall, and I believe the transcript of yesterday's testimony will reflect the fact, [fol. 6405] that the witness stated that during the earlier years of his association with the company that he was assistant secretary and assistant treasurer, and, as such, did not necessarily have direct contact with or assist, other than in a general way, in the determination of some of the matters of policy that I have, since I became secretary-treasurer and since my titles were changed from secretary-treasurer to secretary-controller, been quite intimately associated with and have participated in such determinations subsequent to those changes to a much greater degree than before that time.

My senior officers in the earlier days of my association had more to do with matters of policy than the witness, himself.

Q. Well, it is correct to conclude that since the time, at least, when you became secretary in 1935, that you have been intimately connected with such determinations?

A. Well, even before that, Mr. Gorman.

Q. Yes, but I mean since that time, at least.

A. That is true.

Q. Can you tell us, in a general way, without going into too much detail, how or what method or basis is

used by the management in determining such annual accruals? We touched upon that somewhat briefly yesterday.

[fol. 6406] A. Well, I do not believe I can add any more in that respect than is already in the record. I should be very happy to read the portions of the record that I think are responsive to your question, if that would be helpful.

Q. My inquiry was whether or not you could give it in any greater detail than you did on yesterday. My recollection of your testimony,—of course, it will speak for itself,—was—

A. (Interposing) I think I am willing to let it rest as we left it yesterday.

Q. Your present thought is that you can add nothing to it?

A. Oh, I might, but I do not believe it would be particularly helpful. If such a thing would be helpful to whatever point you have in mind, I should like to give you a little of my philosophy with respect to depreciation.

Q. Well, I am only interested in that to the extent that that represents the basis or method of determining accruals of the management of this company.

A. I think, to an extent, it probably will.

Q. Suppose you proceed to do so. In looking back through yesterday's transcript I, myself, fail to find where you offered any explanation of such method or basis. You offered to refer me to the pages, and if you can do so, [fol. 6407] I would appreciate it.

A. I do not believe I offered to refer you to the pages. I referred you to the entire transcript of the proceedings of yesterday.

Q. I see. Well, will you go ahead with such explanation as you propose to offer?

A. I do not believe I characterized it as an explanation. I think I said that I would be glad to give you what I think is the management's philosophy with respect to depreciation and its determination.

Q. That definition is all right with me.

A. We do not believe that depreciation is subject to the application of a mathematical formula. We do not believe that it proceeds uniformly with the passage of time.

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[fol. 6410] Q. Now, to get back to the subject of our original discussion, can you give us a statement of the basis or method or reasoning which is applied by the management of the company in determining each year the annual accruals to be set aside and the reserve for depreciation of Gas Plant Account?

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[fol. 6411] A. Now, Mr. Gorman, I am going to be as brief as I possibly can, because we have spent a terrific amount of time on this question. I should like to help all I possibly can and if I may try to answer your question, your most recent question, by describing what we may have done with regard to the determination of an amount for the year 1940 and skip any efforts to try to recall all these questions that arose in the tabulations that we might have made in various directions, and the consideration we gave to our wasting-asset problem, and the fact that we might not have a property tomorrow [fol. 6412] or that our product would not be susceptible to use or any of the variety of things that would alter one's estimate made for the immediate future, perhaps we can come to a point where the information you seek is available.

Q. Yes.

A. So that approaching the estimated amount for the year 1940, we, first, gave consideration to the fact that there was on the company's books a certain amount of gas sales and purchase contracts which, for our own purpose, we look upon under the classification of "Old".

I imagine before we get too far along in this proceeding we will hear more about those gas sales and purchase contracts. There is a provision in the Certificate of Incorporation that says that we must amortize those gas sales and purchase contracts on an annual basis at the rate of $24,419.05. Computing that, we find that we must have about $293,000 for that purpose.

There are other gas sales and purchase contracts which, using our own vernacular, we classify as "New". Those gas sales and purchase contracts came into existence subsequent to the procurement of our contract with Detroit City Gas Company, now Michigan Consolidated Gas Com-

pany, and we must provide an amount to take care of those over their life span based on units of sales, as the conditions may be, so we determined an amount for that period.

[fol. 6413] Did I mention the amount that we determined for amortization of the old gas sales and purchase contracts?

Q. The provision of the certificate, the Articles of Incorporation? A. Yes.

Q. Yes, you did.

A. (Continuing.) So that we add another $40,000 for amortization of the new gas sales and purchase contracts.

We have found by studies made over a period of years that our investment in unoperated leaseholds should be completely recovered over a period of about ten years because the average life of the leases themselves, is that period. That gives rise to another $86,000.

Several years ago we determined that, based on the estimated amount of recoverable reserves, it would take about three mills per m.c.f. of production to recover the cost of operated leases.

As I mentioned yesterday, we employed the services of an indepedent consulting engineer, and his approach to the matter of depletion was on a little different basis than that of the company and, generally speaking, we came to the same end.

The depletion on unoperated leases for the year 1940 would be, naturally, based on the estimated amount of gas we were going to produce during that year, and it [fol. 6414] was fixed for the year 1940 at $72,000.

Now, as I mentioned yesterday, somehow we came to a point where, when our total amount of provision was applied to the Plant Account, we had a result of about three percent, so to the figures that I have mentioned we add an amount which, divided by the total Plant Account at the beginning of the year, would give a resultant figure including all of these items that the witness has enumerated, and the amount to be added was something in the neighborhood of three per cent.

That, sir, represents our best judgment for the year 1940 as to the amount that should be set aside and was

the basis upon which a recommendation was made to the Board of Directors. The Board authorized the establishment of $1,900,000. That figure, however, did not include the amount already stipulated in the Certificate of Incorporation, because it is unnecessary for the Board to, again, take action each year on something that the stockholders had already acted upon. The plan, therefore, at the beginning of the year 1940, called for the appropriation from income of, approximately, $2,200,000. I believe, if you will refer to the company's published annual report and, perhaps, also, to Form No. 133, which is a form used by natural gas companies to make a financial and statistical report to this Commission you will find [fol. 6415] that the actual amount appropriated was $2,210,000.

Mr. Culton: You said "this company." You mean this Commission, did you not?

The Witness: If I used the word "company" in place of the word "Commission," I was incorrect, sir. Thank you.

By Mr. Gorman:

Q. Now, of course, that aggregate provision which you just referred to includes reserve other than reserve for deprecition of gas plant, which we have been discussing and which is shown at Line 29 of page of Exhibit 48, does it not?

A. Mr. Gorman, the witness enumerated the items that made up the amount.

Q. Yes, I realize that. I just wanted to ask that clarifying question.

A. If the accounts on Exhibit 48—

Mr. Wheat: (Interrupting) Page 2.

The Witness: (Continuing) —segregate the amount determined by the Board of Directors and the amount actually appropriated, the answer to your question is, "Yes."

Now, as you know, the classification of accounts prescribed by the Commission requires a reclassification of the depreciation reserve, just as it does the Plant Account itself.

[fol. 6416] By Mr. Gorman:

Q. That is correct.

A. So that our actual accounts, per the books, may not carry the exact segregation shown in Exhibit No. 48 and may not, at this moment, represent the amounts that would have shown, shall we say, at the end of the year 1940 in Column L on the appropriate lines or in Column M on the appropriate lines of June 30th, had such segregation been made. It is not yet completed.

Q. Can you supplement your answer by giving us a statement of the consideration by the management of the fact that the company is dealing with a wasting asset in providing an amortization provision annually for Gas Plant Property as distinguished from contracts for producing and non-producing acreage which you have previously mentioned?

A. I am afraid I do not understand what it is that you would like to have me do.

Q. Well, as I recall your testimony of yesterday, you stated that in determining the annual accrual the management did consider and provided a certain amount for amortization in addition to depreciation of Gas Plant Property and that this was brought about by reason of the feeling of the management that they were dealing with a commodity which, by reason of the manner of its production, was considered as a wasting asset and that [fol. 6417] in determining and considering amortization allowance there was no specific period or term of amortization provided.

Now, I am asking you if you can give us a little more complete explanation of just how the management did consider this matter of amortization of Gas Plant Property other than those amounts which have specific rates to which you have previously made reference.

A. I assume, sir, you will take no offense if I suggest that your reference to what I stated yesterday be limited to the inability of each of us to exactly remember what we may have said in the precise words. I think I said, in general, what you recited.

Now, if you have this in mind, perhaps I can get to the point you are after.

If you are seeking to learn whether or not, in all the effort we consume to determine these annual amounts, there was a specific rate that we used for amortization of the physical properties, or a specific number of years we used to determine that, the answer is no.

Q. I understood that from your testimony of yesterday, but I do not understand that the management merely considers that they are dealing with a wasting asset and, accordingly, plucked some specific amount out of the air.

A. Oh, certainly not.

Q. What I am trying to get at is how they arrived [fol. 6418] at the amount which they do so provide for amortization.

A. Well, that is based on our best judgment. Now, we do have certain things, as the record of this morning's session will show, that are provided on specific bases. As the witness has testified, there is then added to those amounts an amount which includes both amortization and depreciation, as it is commonly known, and as it relates to the wasting away of the physical assets in actual use.

Specifically, we have not had a definite rate for either of those two amounts. We used our best judgment, which converted into a percentage after we were finished, that amount plus the sum of the specific amounts, came to about three per cent, sir.

Mr. Wheat: What you are trying to say is that you do not start with a percentage and apply that, but that over these years which you have had to do with this matter you have had certain specific amounts and you have added other amounts and afterward, as you come to look at that, you have found that it has approximated three per cent in those years?

The Witness: If that satisfies Mr. Gorman, Mr. Wheat, I have certainly wasted a lot of time.

Mr. Wheat: No. Can't you answer my question?

The Witness: That is what I have been trying to say.

[fol. 6419] Mr. Wheat: Thank you.

By Mr. Gorman:

Q. Yes. Well, I think you have said that on several occasions, but that, as you seem to think, would not quite satisfy me.

A. Well, I do not know, sir.

Q. Well, I am not sure that we still have got to the point which satisfies me, Mr. Watkins, and that is, you stated the amount which you add to your other figures, which amount is a provision for amortization, represents a judgment figure. That was your statement, was it not?

A. Yes, I think so.

Q. Yes. Now, what I am trying to secure from you, Mr. Watkins, is the basis of that judgment. In other words, what factors do you consider? Do you just consider the fact that it is a wasting asset?

A. Oh, no, indeed. Mr. Creveling has been engaged in the gas industry for years and years and years. He knows it backwards, forwards, top and bottom, inside and outside. He has bumped into, unquestionably, all the problems that can be gathered together that have been the experience of all the gas companies. Of course, he has not bumped into the ones that we will have in the future.

Q. We will agree with that.

A. My experience in the gas industry goes back to 1926. [fol. 6420] In know a few of those things. There are others connected with our organization in an operating capacity and in a managerial capacity that have the same line of experience either in the gas industry, or otherwise.

Now, the composite of the thoughts of all of us, based on our experience, our investigations, our discussions, our general knowledge, has led us to the conclusion that this is a good thing, and that is what we are using for internal purposes, not for rate purposes and not for income tax purposes.

Q. Well, by that do you intend to indicate that the approximate figure of about three per cent annually, is a good figure? Is that what you meant?

A. It is a good figure for our purpose. It is not intended to represent a life span. We went over that time after time before and, if I may anticipate, that is the thing that is troubling us now; we have not definitely concluded in our mind what should be a proper one because we do not have enough knowledge at this time.

I mentioned yesterday that this is a new industry; long-distance transmission of gas is something that probably is not over ten years of age. Many of the long-distance transmission lines did not get into what one would consider full operating condition until perhaps seven years ago, or something of that nature. Our retirements have not been suffi- [fol. 6421] cient at this time to indicate what might happen by way of physical deterioration. We do not know what confronts us by way of functional effect of depreciation. We do not know what confronts us in the way of depletion. There are so many unsettled things that it would be most unwise at this time to try to arrive at a mortality figure. The information just is not available.

Q. Yes. Well, you answered my question very quickly and your answer was that the figure to which you previously had reference was the resultant figure of approximately three per cent.

A. It resulted in approximately three per cent, sir.

Q. That is right. I thought that was what I said.

Now, do I understand correctly that after you have computed your depreciation and the various amortization provisions for other items of property, that to that resultant figure you add an amount which we have been designating as an amortization provision for gas plant property which is sufficient to bring it up to the resultant figure of approximately three per cent?

A. No, sir, we do not make any such addition. The addition that you speak of is a mental process.

Now, if we could move time back, shall we say, to about [fol. 6422] 1936, when we went through all of the things that we have been discussing here, and determined an amount that we thought was sufficient for our internal purposes at that time, and that, as we have gotten into the record numerous times, resulted in rate of about three per cent, so that as we came along in the subsequent years and we found no particular reason to change the basis upon which we had approached this matter before, it was simply a mathematical calculation of what we expected to have at the end of the year.

Q. Well, when you say "mathematical calculation", do you mean that the amount provided for amortizing gas

plant property is a calculation? I understood previously that that was a judgment figure.

A. No, sir, I am talking about the composite whole.

Q. Oh, I see. This amount provided for amortization of gas plant property is wholly a result of a discussion, so to speak, around the table and then in that discussion you arrived at an amount which you are going to set up for that particular year?

A. Well, I think that probably would be all right. Let's put it this way: If we were using a fixed rate of six per cent or 60 per cent, some portion of the six per cent or the 60 per cent, in our judgment would represent the amount that an industry such as ours should provide annually as [fol. 6423] amortization of facilities that would not be completely used up when its reserves has been completely exhausted. It is part of the composite whole, just as you might say that because of the retirement unit provision in the classification of accounts used by this Commission our depreciation reserve or our reserves for depreciation and amortization, however we choose to characterize them, are going to be increased substantially, because we now have to work small units of property in and out of capital, whereas before we may have charged them to maintenance, or that one of the reasons for an upward trend in the annual provision is because the State Highway Commissions in Kansas, Missouri, and Illinois, are going to indulge in a tremendous road buildnig program which is going to involve the changing of a lot of facilities and, as a result of that, we, again, have our units of property to contend with and that affects the depreciation reserve.

There are so many things of that nature that can cause the conclusions to be changed at different periods, even changed within an annual accounting period, that one cannot specifically put their thumb down on them and catalog them or characterize them as something that is going to recur constantly in the same manner, in the same fashion, at the same time, and in the same proportion.

What I am trying to say is that we have made a desperate [fol. 6424] effort to arrive at a conclusion which when applied to the company's property and taken out of the company's gross earnings will be such year for the purpose these reserves are intended. We may have erred terribly.

That error, if [they] be any, may be on the upward side. It may be on the downward side. Here is what we have done; it is our best judgment, and I am afraid we will have to leave it just as I once heard of a Negro boy who had bought a watch. Another high brown came along and asked him what time it was. The second Negro looked at the watch and said, "Dar she is," and the other Negro said, "Damned if it ain't!"

Q. Well, now, of course, your analogy there is not, in my mind, a good one, so that is neither here nor there. I think you will agree with me when I say that apparently I am very dense because I still do not understand just what you do or why you do it.

A. I would not say that at all, sir.

Q. I am just trying to clarify it in my own mind. If everybody else understands it, I apologize for taking up so much time.

Now, as I understand your feeling and the feeling of others of the management, after you arrive at an amount, before you provide this other amount for amortization of Gas Plant Property, you have the feeling that your result [fol. 6425] is not adequate. Is that correct?

A. Oh, no, no.

* * * * * * * * *

Q. Let me put it this way, you do have a definite feeling that to reflect your best judgment and to provide what you consider to be an adequate amount, you must provide a specific amount which you determined by a judgment calculation for amortization of your Gas Plant Property?

A. We make no specific calculation, applicable only to the amortization. Now, there is only one of the several things that the witness mentioned a moment ago that is specifically based upon the Certificate of Incorporation, and that is this amortization figure which runs around [fol. 6426] \$293,000 a year and is stipulated in the Certificate of Incorporation at the rate of \$24,419.05. That is the only definite thing that our Articles of Incorporation say we must do.

Now, everything after that is something that we arrive at without direction from the Certificate of Incorporation, if I may use that language.

Q. Yes? Well, I think we all so understand.

A. So that, to repeat, we take the other gas sales and purchase contracts and work out an amount which will provide the recovery of the total amount at which those gas sales and purchase contracts are carried on the company's books over their life or, if they be based on some unit of sales, on the basis of the unit of sales that is added to the amounts specifically required by the Certificate of Incorporation.

We then treat our amortization of unoperated leaseholds separately. As I have testified, we find that a 10-year period is about what is required for those, so we set up one-tenth of that in this mental computation and then we come to our operated leaseholds and we have found, as I have previously testified, that a rate of about 3 mills per M.c.f. of gas produced was good enough for that, so we then make that computation.

Now, the sum of those items represents the things that we have thus far determined.

* * * * * * * *

[fol. 6427] Now, when we get to that point, there is then the necessity of providing for both what we choose to consider physical deterioration and amortization.

That is a composite figure and it, added to the sum of these other four elements that I have mentioned, divided by property, usually comes out to 3 percent.

* * * * * * * *

Q. Yes. Now, if we just understand each other that we are only talking about this last amount, disregarding everything prior to that but the physical depreciation and the amount provided for amortization, which goes together as I understand your last statement, which is separate and apart from everything else you have mentioned such as contract provisions, reserve for amortization, depletion for producing natural gas lands, reserve for abandoned leases and other things of that ilk which have a specific manner of annual determination, it is this last figure that you mentioned which I am discussing solely and that, as I understood you to say, is strictly a judgment figure.

A. Well, there are many things that enter into the determination of that judgment and I have tried to tell you what they were this morning.

[fol. 6428] If we want to wave those all aside and just simply call the amount a judgment figure, I do not think I could agree with that. I can state, as I have two or three times, that it is not based on a specific life span.

Q. Yes.

A. And, therefore, has not specific rate.

Now, it might very well be that if we took that figure alone and divided by property, it would come out to, let us say, somewhere in the neighborhood of 2.75.

I do not know whether it will, but suppose it did, it is not significant, so far as we see.

Q. Of course, it has great significance, the whole resultant figure. Whether you come out at 3 percent or whether you come out at 10 or 15 percent, I think it has a great significance.

However that might be, you indicated that this last amount, which you understand we are now discussing, is to provide not only for physical deterioration but, also, a certain provision which may or may not be set aside or cataloged in your own mind as an amount sufficient to amortize and depreciate your property by the time that you anticipate your gas supply will have been exhausted.

Now, is that correct?

A. Well, the combined total of the two has been provided by us for those purposes and any other purpose that a [fol. 6429] depreciation and amortization reserve applicable to property may be needed at some indeterminable time in the future.

Q. Now, isn't it your testimony that you and others of the management feel in considering this last figure that we have been discussing that an amount, which you estimate to be equivalent to physical deterioration, considered in conjunction with the other amounts provided for amortization and depletion of producing natural gas lands, reserve for abandoned leases, and your reserve for contracts, would not be sufficient to recover your investment at the time the gas supply had been exhausted?

A. We sincerely hope that it will be.

Q. Now, I wonder if you understood my question properly. A. Perhaps not.

Q. Because I did not mention any provision for amortization of gas plant property over and above the amount you had provided for physical deterioration.

A. We have made no specific provision for either deterioration or for amortization of the physical property.

We have made a provision and our records do show the result of that provision and the residue of the provision made to take care of those things and any other elements or functions that give rise to the march of our properties to the junk heap.

[fol. 6430] Q. Well, of course, Mr. Watkins, that is merely repetition of what you have said before and does not clarify my question whatsoever.

Let's go back and put it down in somewhat detail. First, you have an amortization provision.

A. First, we determine, sir, that we must follow the Certificate of Incorporation, we have no choice.

Q. Which provides an amortization for gas contracts?

A. So if we follow that we have to have $293,000.

Q. That is for the gas sales and purchase contracts?

A. (Continuing) As stipulated by the Certificate of Incorporation and over a ten-year period.

Q. Secondly, you have what?

A. We have other gas sales and purchase contracts for which we provide amortization and apply that amortization monthly to the Asset Account.

That varies from year to year, based on the amount of such account, and is determined by the life of the contracts to which the amounts are associated, or on a gross sales basis, or some unit basis, if such a thing is present.

For the year 1940 it ran around $40,000, so you may write down, in addition to the $293,000, $40,000 for other gas sales and purchase contracts.

Q. Thirdly, you have what?

A. We have investment in unoperated leases which, as [fol. 6431] has been stated many times this morning, we determine should be recorded over a ten-year period.

The computations with respect to that developed an approximate amount for the year 1940 of $86,800.

Q. Fourthly, you have what?

A. Unoperated leases. On the basis of the estimated gas to be produced in the year 1940 times 3 mills we arrive at a figure of $72,200.

Q. Did you say "unoperated" or "operated" leases?

A. If I said, "unoperated", I am incorrect.

Q. Well, I understood you to say "unoperated". You meant "operated"?

A. This last item we are talking about is operated leases. It is providing depletion for that purpose.

Q. Your fifth item is what?

A. The fifth item we call depreciation in a very broad sense of the word and is intended for all other purposes that it may be needed. That figure, in our estimate for the year 1940, was $1,708,000, the total of which is $2,200,000.

When this was presented to the Board, the only action the Board took was with respect to $1,900,000 of that.

Q. Now, as I tried to indicate before, I think we have disposed, at least for the time being, of the first four items which you have mentioned, which leaves only the fifth item.

[fol. 6432] A. $1,708,000 estimated.

Q. (Continuing) Which, in your last analysis, you have characterized as depreciation. A. Very broadly.

Q. Yes. Now, was it not your previous testimony that in this fifth item you include not only physical deterioration as depreciation, but you, also, include an amount for amortization?

A. It gives consideration, sir, to both of those items.

Q. Yes.

A. And any other item that we may have. Whether or not we include in our mind's eye blank dollars for the one or the other, I do not believe anybody can say because we simply did not do that.

Now, if you could tell us or anyone else could tell us exactly and precisely what we should do with respect to that item, you certainly would render a tremendous service to us.

Q. I am not trying to indicate what you should do, Mr. Watkins, I am merely trying to find out what you did do.

A. I am telling you that your help would be quite welcome.

Q. I can fully appreciate that.

So that in arriving at the amount to be provided for this last item, which you said in 1940 was estimated to be $1,708,000—

[fol. 6433] A. (Interposing) And actually was $1,720,744.97.

Q. (Continuing) That represents the best judgment of the amount to be set aside for this Item No. 5 of depreciation, including amortization, by the management of the company as arrived at by a round table discussion?

A. Many, perhaps, such discussions.

Q. Yes, but it is solely the result of discussion by the management?

A. No, I do not think you could say that, Mr. Gorman, in the light of all the remarks the witness has made with respect to this.

We do not want to go around that circle again, I hope. We just did not simply sit down and discuss this, certainly not. The length and breadth of the experience of the people connected with the company, the information we could assemble from all other organizations similarly situated to ours, the general knowledge that we gained with respect to these matters, the interest that was developed with regard to such things in the American Gas Association, The Controllers Institute, The American Institute of Public Accountants, the advice that we could get from our own accountants, the man in the ditch that could help us about this, that or the other thing, the things we observed that were happening to other gas lines and gas properties, the knowledge we gained of what might be the trend of the development [fol. 6434] ment of further reserves, the things that we sought that might shorten the life of the reserves and all of the conglomeration, if you please, of things that must be considered went into the consideration of this and we did not sit down at any particular table and any particular time and make such a determination. It was a long, laborious thing.

Q. And it, as I understood your testimony, represented no division for physical deterioration or other provisions for other purposes?

A. No, it is a composite amount for whatever purposes it may be required.

Q. And did that figure result in any sense from a feeling of the participants in such discussions that the amount to be set aside for this Item No. 5 in each year when added to the amount provided in the first four items must be sufficient to enable the management to recover its investment within a given period?

A. Not with respect to a given period. I do not know how to make that any more definite than I have many times during this testimony.

We expected and hoped that the amount would be sufficient if continued and if adjusted as adjustments were necessary or required, either upward or downward, to recover at the time when such recovery became necessary the entire investment in the facilities, the use of which gave rise to [fol. 6435] such determination.

Q. Yes. A. If I may interrupt?

Q. You may.

A: I should like to caution us about characterizing this one thing as Item No. 5. Let's think of it as Element No. 5.

Q. I will appreciate it if you will.

A. Mr. Gorman, perhaps this would add to what you have in mind, I do not know; if it won't, you may stop me if you please.

The result of the method that we have been discussing here this morning for the years 1937, 1938, 1939, 1940 and estimated for 1941, comparing the plan with the actual and what follows, would you like to have that?

Q. Well, by that you mean the recommendation of the management as compared with the final determination of the Board of Directors?

A. I am going to give you, sir, the resultant percent of the plan and of the amount actually provided after the determination by the Board as compared with the investment at the beginning of the year, if it will be of any service to you.

Q. Suppose you do that.

A. This we understand to be simply a percent.

Q. An equivalent percent?

[fol. 6436] A. Yes, an equivalent percent of the fact, shall we say?

In 1937 the plan and the authorization by the Board resulted in 2.58 percent; the actual amount recorded was 2.7 percent.

In 1938 these comparable figures were 2.77 and 2.8.

In 1939 they were 2.82 and 3.

In 1940 they were 2.96 and 3.0.

In 1941 they are estimated to be 2.99 and 3.09 percent.

Q. The first figure that you gave was—

A. (Interposing) 2.58.

Q. No, I did not mean specifically in numerals.

A. It represented the result of the application of the amount the management determined and recommended to the Board and the Board acted upon plus the amounts stipulated by the Certificate of Incorporation to the Property Account at the beginning of the year, each year.

Q. And the figure each year represented—

A. (Interposing) The actual application of such determination and such approval by the Board.

Q. That is the application on the books? A. Oh, yes.

Q. Yes.

A. I believe I mentioned yesterday that for the year [fol. 6437] 1942 the plan might run on the order of 3.2.

Q. Yes.

A. Actually I think it is somewhere in the neighborhood of 3.18. I should not like to be bound by those last two figures.

Q. Now, of course, at the time of the determination of the annual accrual, I assume it is the judgment of the management that upon the circumstances as of the time of determination their decision, of course, is a proper one for that year and upon such facts as they stand at that time, in so far as they know them, it would be entirely proper to continue, all other things remaining the same, the allowance of such amounts throughout the history of the property?

A. Well, the answer to the first part of your question would, necessarily, have to be that management could not very well impeach itself.

If it determined an improper amount, it will certainly have to stand by it.

As to the second phase of the question, if I understand that correctly, if there be no presence of disturbing influences with respect to the future and such an amount were applied proportionate to the investment in property over the subsequent years and if the amount up to that time had been adequate and we had come out exactly even, then the answer is "yes".

[fol. 6438] Q. Yes.

Mr. Watkins, you have from time to time in the discussion of this question of reserves for depreciation and amortization referred to the fact that these figures and computations and methods used were satisfactory for internal purposes but for no other.

Now, will you please explain to us what is the significance of your phrase, "internal purposes"?

A. First, at Page 6395 of the transcript of the session of the afternoon of January 22, on Lines 16, 17 and 18, the witness in response to a question you asked stated, "Well, sir, I am simply trying to say to you that I am in no wise trying to testify to depreciation to be or not to be included in a rate proceeding."

The position of the company with respect to its provision for this purpose, as shown by the witness' statements relating to internal purposes, is that its records are not kept for purposes of determining the net taxable income in the manner prescribed by the regulations pursuant to the effective Revenue Acts nor do its records in any fashion [pretend] to represent a base upon which there could be applied a rate of return in rate proceedings, nor are the records maintained in such manner that information may be extracted immediately from them and used, without adjustment, for any other purpose which it might become [fol. 6439] necessary to treat with, any investment or liability or other item that was shown on the company's books at any time in any manner wherein such an adjustment need be considered in the development of data responsive to any regulation, question or otherwise.

Now, when we speak of internal purposes, including the explanation that has just preceded this remark, we think of the company affairs in the light of their use in any direc-

tion other than those that I have heretofore specifically mentioned.

Q. Well, as I understand your answer then, your books and records are satisfactory for the purposes of consideration by the management but for no other purposes?

A. Oh, no.

Q. Well now, let's see. You said they were not satisfacory—

A. (Interposing) Our books are predicated upon sound accounting practices and accepted standards for correct and proper accounting methods.

Q. Yes, but, of course, they are not satisfactory for rate proceedings?

A. I do not believe that it is possible at this moment, at least, to interpolate rates into books of accounts, sir.

Q. So that for a rate proceeding you will have to, more [fol. 6440] or less, set up a new set of books?

A. Oh, I do not know about that. When you come to rate proceedings, sir, you have me out beyond my depth. I know little or nothing about rate proceedings, I am having my eyes opened, however.

Q. You were the one that made the statement, Mr. Watkins, that they were not satisfactory for rate purposes.

A. I do not believe I said that at all.

Q. I so understood.

A. I should not like for you to so interpret my remarks in that respect.

Q. I just misunderstood, then. I understood—

A. (Interposing) I said they were not kept specifically for that purpose.

Q. Well, naturally not.

A. If I said something else, I must correct myself, because I did not intend to say that.

Q. We understand now what is your statement.

A. O. K.

Q. Do you think that they could not be used for rate proceedings' purposes? A. As such?

Q. As such.

A. I do not believe they could, no, from what little I know of rates.

[fol. 6441] Q. So from what little you know of rates, you do think it would be necessary to set up the equivalent of a new set of records?

A. Well, I would not characterize it as a new set of records. I see in this proceeding here where we have something in regard to claims for this or a statement made with respect to something else.

There have been over 6,400 pages of testimony thus far. The record must have some purpose with all that stuff in it.

Q. Yes, I imagine that is true, but you do not know the answer to my question?

A. I do not know but very little about rates, if that is what we are talking about. When I say "rates", I mean rate proceedings, of course.

Q. Yes.

A. Let us say this, Mr. Gorman, maybe this will be helpful, it is most infrequent that records can exactly coincide with the statutory conception of information that much be extracted from those [recrods] for a varied number of purposes.

Recognition, I believe, of that theory, is present in most everything we do with our books of accounts. For instance, this Commission, by its Order No. 86, has established a very voluminous report with respect to companies subject to the Natural Gas Act and that report includes a tremendous amount of information that is not present in a company's books of accounts.

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[fol. 6443] By Mr. Gorman:

Q. Let us turn our attention, now Mr. Watkins, to the next account shown on Page 2 of Exhibit 48 at Lines 30 to 32, which is the "Reserve for Amortization and Depletion of Producing Natural Gas Lands and Land Rights."

This reserve represents, does it not, the balance remaining of the accruals which are shown at Lines 11 and 12 on Page 1 of Exhibit No. 49?

A. It does, and is a result of a part of the plan that we have been discussing here this morning.

Q. Yes.

A. Our discussion, as I understood it, took into consideration all of the reserves shown on Lines 27 to 33, inclusive on Page 2 of Exhibit 48.

Q. Well, I attempted, of course, to confine it to the several accounts. However, I realize that the testimony got beyond that scope and did touch upon these other matters.

Now, the accruals in this reserve, as I recall your previous testimony, are provided upon a basis of three mills per thousand cubic feet of gas produced, is that correct?

A. At the present, yes.

Q. And how long has that been the method of computing [fol. 6444] the annual accrual to this reserve?

A. Since the first accrual of this nature made by the company, so far as I know.

Q. And that was made when, do you know? You mean that goes all the way back throughout the history of these properties?

A. Apparently it was made in the year of 1932. Yes, it goes all the way back throughout the history of these properties.

Q. Including the time the property was held by a subsidiary of the company which has since been dissolved?

A. We are referring to Texas Interstate Pipe Line Company?

Q. Yes. A. Yes.

Q. Now, I notice that on Exhibit 56 you have set forth the annual production of natural gas by the company. Are these figures computed upon a basis of measurement other than that which is used for the determination of the annual accrual for this reserve we are now discussing?

A. The basis of measurement has nothing to do with the accrual. We determined the amount of production, on whatever basis was used, and then reported the amount of gas produced upon that determination.

We give no consideration to the fact that it may have [fol. 6445] been anything other than 16.4 absolute pressure gas as shown in Note No. 1 on Line 13 of Exhibit No. 46. As a matter of fact, it is my remembrance that that has been the basis that has been used throughout the entire history of the company, so far as gas produced is concerned.

Q. And the annual accrual will be determined simply by the multiplication of the figures which appear in Column E

of Exhibit No. 56 for the respective years by the amount of three mills per thousand cubic feet?

A. Well, it would not be exactly that because the accrual, as a matter of fact, is made monthly and based upon the monthly production figures.

It should be substantially the same.

Q. I see. Referring to another item in your direct testimony at Page 885, you stated that for drilling costs, well equipment and other production system property, the annual accruals are computed at a rate of 6 percent per annum. That is correct, is it?

A. No, not computed at that, but, in determining distribution of accruals and so forth, we give consideration to 6 percent per annum for the properties referred to there.

Q. And has that figure been used throughout the history of this property? A. Yes, it has.

Q. Turning now to the account for the reserve for [fol. 6446] abandoned leases shown at Line 33—

A. (Interposing) The amounts shown there represent the third element of our determination for the total amount to be authorized or rather to be recommended to the Board for consideration.

That is simply the result of the amount set aside monthly for the eventual time when the investment in the unoperated leases must be fully recovered and is based, as I have previously testified, on an estimated ten-year life, so that we take the total amount when our accruals are made of our investment in this particular type of assets and apply the ten-year basis to it.

Mr. Culton: In other words, your ordinary lease provides if it is not drilled within ten years, it terminates?

The Witness: That is true and the average that we are using of ten years, Mr. Culton, is based on the average life of all the leases that we own.

We find that the ten-year period has not changed a great deal over the past years. Some of the leases may, from the time we acquired them, run for a very, very few years. Others, their primary terms may have been extended so the life represents about a life of ten years.

By Mr. Gorman:

Q. When you say "all leases", do you include operated and unoperated leases?

[fol. 6447] A. No, the operated leases are provided for, as the record shows, in the reserves shown in Exhibit 48, on Lines 30, 31 and 32. That is depletion, as we understand it.

Q. Your phrase then, "all leases" merely refers to all unoperated leases? A. That is correct.

Q. And is this reserve set up with the idea of recovering those amounts which are shown in the gas plant account, Exhibit No. 52, Page 1, at lines 11 and 12 and there designated "Natural Gas Producing Leaseholds—Not Drilled"?

A. Yes, that is correct. The amounts shown at the end of the respective periods stated in this exhibit do not necessarily become the basis upon which the monthly accruals are made because they change from month to month, as you can imagine.

Q. But these reserves are set up as a credit to this [accout] for natural gas producing leaseholds—not drilled, is that correct?

A. That is correct, and my remembrance of the need for the repetition of the language, natural gas producing leaseholds, is that the Power Commission Classification makes no distinction between drilled and not drilled leaseholds.

Am I correct there?

Q. I think you will find that is true.

Now, Mr. Watkins, do I understand that the ten-year term [fol. 6448] over which you provide amortization for these abandoned leases is due to the term of the lease itself or to the period during which the lease is operated or held?

A. It is due to the term of our ownership in the right granted by the lease. Frankly, I do not know the exact difference between a lease and a leasehold. I construe the lease to be the instrument and the leasehold to be the thing that you get by reason of the instrument.

Now, the thing that our ten-year period is based on is the fact that we own whatever right the lease gives to us on an average of ten years for the leases that we have and have

done so over the entire life span of the company up to this date.

Some of them we may have had ownership in only a few years. Others we may have owned them for their entire primary term, which is customarily ten years, and may have extended it for another ten years.

Now, our period of amortization gives consideration and contemplates the ownership of all the leases for an average of ten years.

Q. Referring again to Exhibit 52, and I skip to this exhibit because the questions are so correlated, does the significance of the language "Natural gas producing" and I emphasize "producing", "leaseholds—not drilled", indicate these leases are producing although they have no wells located thereon? Is that the intention?

[fol. 6449] A. No, sir, that is not the intention, necessarily. I believe the witness has stated, on several different occasions, that in the preparation of the exhibits introduced in these proceedings through him, we thought we were being considerate, shall we say, of the Commission in trying to prepare the exhibits after the manner of the balance sheets, income statements and so forth, generally included in the Commission's Classification of Accounts.

Q. Yes.

A. And if we used some language in them that is susceptible to ambiguous interpretation or rather different interpretation, it was not intentional.

Q. Would you say that this account is set up under the instruction contained in Account 100.4 in the Commission's System of Accounts for Natural Gas Companies?

A. I have not given consideration to that, sir.

Q. You say you have not? A. I have not, no.

Q. Well, that account is designated as "Gas Plant Held for Future Use". Would you say that the items contained in your account for natural gas producing leaseholds—not drilled, is land and land rights held to insure a future supply of natural gas?

A. Without indulging, if I may avoid doing so, in any [fol. 6450] discussion as to what my personal feeling might be with respect to property in use or property held for future use, I should like to answer your question this way:

That we have segregated, in our records, our ownership in leaseholds as between drilled and not drilled. There is some difference of opinion, I think, between myself and the Classification of Accounts in more places than that.

My feeling is that whatever leaseholds the company has, whether they be at that particular moment producing or not producing or in service, we have separated them here and have kept them separated on our records so they may be treated in whatever manner is termed appropriate.

Q. Yes. Is it the proper interpretation of your intention in designating these accounts to refer to the account shown at Lines 9 and 10, Page 1, of this Exhibit No. 52, instead of saynig, "Natural Gas Producing Leaseholds—Drilled" would it be proper to say, "Natural Gas Producing Leaseholds distinguished from Non-Producing Leaseholds"?

A. The distinction is simply this: The amounts shown on Lines 9 and 10 in Exhibit No. 52, for all the periods, represent the company's investment in leaseholds which, at the date certain for which the information has been prepared, were producing or they were drilled, as you wish, and that the amount shown on the lines opposite the caption on Lines 11 and 12 represented the company's investment at the date certain shown on this exhibit in natural [fol. 6451] gas leaseholds which had not been drilled.

Q. I see.

A. Now, it could very well be, if I understand correctly, that some of the leases included on Line 12 in the various columns of this exhibit, or a great many of them for that matter, were susceptible to drainage at that particular time.

If we look at the year 1932, for example, out of the $1,-455,000-odd shown there, there may be values in the neighborhood of $5,000 or $50,000 or $500,000 that later become a part and parcel of the amounts shown on Line 10 in the various years on this exhibit.

Q. May we properly conclude from this, then, that the producing leaseholds designated as "drilled" are those upon which you pay royalty payments to the lessors?

A. Yes, because we own no producing lands in fee.

Q. And would it also be proper to conclude that on the leaseholds set up in the accounts shown in Lines 11 and

12 as being not drilled, you do not make royalty payments but only pay delay rentals?

A. As far as I know, there is not a single lease represented by any of those amounts to which you have just referred on which the company makes any royalty payment whatever.

Mr. Culton: The latter part of your question, Mr. Gorman, I might clarify.

[fol. 6452] Are there some tracts which have not been drilled but on which the company pays no delay rentals because of drilling operations on other tracts covered by the original lease?

The Witness: Yes, and to that extent, Mr. Culton—

Mr. Culton: (Interposing) There may be no delay rentals payable on portions of the items on Lines 11 and 12?

The Witness: I doubt very seriously, sir, that any of those amounts remain in the classification shown here, "Natural Gas Producing Leaseholds—Not Drilled."

That has been our custom throughout the years where a leasehold was involved in a block of land cured by the drilling of a well.

Mr. Culton: There are delay rentals on all of those covered by 11 and 12?

The Witness: Correct.

Mr. Culton: That answers the latter part of your question.

Mr. Gorman: Yes.

By Mr. Gorman:

Q. When a well is drilled on any of the leaseholds which are included presently in the account shown at Lines 11 and 12 for not drilled leaseholds, I assume it is transferred then to the account for drilled leaseholds?

A. Our investment in such acreage, including the acreage [fol. 6453] covered by the lease upon which the well is actually drilled, plus the cost to use any acreage for which we no longer have to pay delay rentals by reason of the drilling of that well, are forthwith transferred to the other account.

There is this point that I should explain to you and you may have some questions to ask about it later, and that is this: That at the time such transfers are made, there is no transfer made from the reserve accounts.

Now, our ten-year life span and our three mills per M.c.f. contemplate that fact. We are engaged just now, as you know, in the reclassification of our reserves and it may very well be that there should be some transfers made from the amounts shown opposite Line 33 on Page 2 of Exhibit No. 48 to the amounts shown opposite Line 32 on the same page of the same exhibit, or vice versa.

Q. And you say there have been no transfers from that reserve account in past years?

A. Coincident with the transfer of the investment in a non-drilled lease to the account in which the drilled leases are placed, there has not been any such transfers.

I do not mean to say by that, if I may speak further, that the result of that would be that the reserves have been duplicated. I tried to make that plain. I hope you understand that.

Q. I think so, yes. I think the record will so disclose. [fol. 6454] Of course, in connection with your last statement, the result would be, would it not, that for a period you have depreciated your investment in these leaseholds on a basis of 10 percent per year or one-tenth based upon your life of ten years, as you have previously testified, and then when you transfer that to your drilled leasehold account, you again commence the depreciation of these same dollars upon a basis of three mills per thousand cubic feet of production?

A. We continued the amortization upon the basis of three mills.

Q. Do you not—

A. (Interposing) We do not transfer the balance from one of the reserve a counts to the other but the composite basis of arriving at the reserves contemplates this situation.

Q. Yes, but my question, of course, is directed to the fact that at the time you make your transfer from your non-drilled account to the drilled account, you transfer your entire investment—

A. (Interposing). Yes, I have stated that.

Q. Can you state offhand at the present time, Mr. Watkins, whether or not there have been any substantial amount of leaseholds abandoned by the Panhandle Company in recent years?

A. Quite a substantial amount, yes. If you wish to [fol. 6455] have me do so, I will see if I have something here that will be helpful. If not, I probably can answer your question more specifically this afternoon. What is your pleasure?

Q. If you have the information, we will be pleased to have it in the record.

A. I have an analysis which shows the balance of this account at the end of 1931 and at the end of the year 1940, those amounts being, respectively, $17,100 and $710,486.45.

During that period, charges were made to the reserve account aggregating slightly over half a million dollars.

Q. That is for the period from 19—

A. (Interposing) If you will excuse me, please.

There have been included in [thos] charges, certain amounts representing the cost of leases transferred to the production group, that is, the natural gas producing leaseholds.

My data here does not show the exact charges represented by leases abandoned or surrendered or disposed of in some other manner.

If it will be helpful to the Commission, I shall attempt to supply that information for the period or for any annual period.

Q. Well, as I understand the qualification of this, the amount which you have just read would include not only abandonments and surrenders but also leaseholds transferred to the drilled account?

[fol. 6456] A. Yes, or any other adjustment which it is necessary to normally make in the account.

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[fol. 6457] Q. Will you please turn your attention to Line 36 of this Page 2 of Exhibit No. 48 which is the account for "Other Reserves".

I think in your explanations of yesterday you testified up this matter somewhat.

A. Well, I would say completely, sir. I think we covered it rather broadly.

Q. I believe that is so to the extent, at least, of showing the charges made to this account in the various years.

A. May I refer to those as credits rather than charges?

Q. Well, when I used the phrase "charges" at that time, I merely meant "entries".

A reference to a Registration Statement which was filed by the Panhandle Eastern Pipe Line Company with the Securities and Exchange Commission on July 7, 1939, indicates at Pages S-20 and S-22 of such statement that in 1937 there was added to this reserve $96,800.94 and in 1938, there was added to this reserve $328,000 and, on Page S-22 of this Registration Statement, is an explanation which reads as follows:

"Excess of provisions for Federal and State income taxes over revised estimated liability therefor ($96,800.94 applicable to 1936 and $328,000 applicable to 1937) transferred to the reserve for contingencies pending final determination of such liability by the Treasury Department and the State income tax authorities," and further, at Page S-24 of the Registration Statement identified as Exhibit [fol. 6458] No. 145, there is indicated that during the year 1939, there was made a further charge to this account of $200,000 and, on that same date a reference to a note which reads:

"Excess of 1937 provisions for Federal and State income taxes over revised estimated liability therefor, transferred to the reserve for contingencies."

Of course, as will be seen, the addition of these three items represents your total at June 30, 1941, of $624,800.94.

May I ask whether, since June 30, 1941, there has been a final determination with respect to any of these tax obligations for which provision has been made in this reserve account?

A. Well, you are asking a question of me that has likewise been one that I should like to ask of someone else.

When, if ever, you reach a final determination of some of your Federal income tax matters, it is a thing I should like to know.

As to the year 1936, which really is the only year open among those you included in your question—

Q. (Interposing) Mr. Watkins, I believe that was 1937, was it not? You said 1936.

A. The amount of $624,800.94 includes some $76,000-odd that had to do with the excess accrual for the year 1936 so that, to start again, as to the year 1936, we have recently executed the Internal Revenue Department's Form 874, I believe it is, agreeing to the refund by the Revenue Depart-[fol. 6459] ment of a certain amount of the taxes heretofore paid by the company for that year and, as the record will show as to the year 1937, there were no Federal income taxes for that year because of the refunding operation consummated during that year.

The Internal Revenue Department thus far has had no particular interest in the year 1937. Apparently it appeared to them to be such a big loss year that it was not fertile ground for further cultivation.

This witness could not definitely say that the year 1937 is closed or that there will be no further assessment. I should say there will be no assessment instead of further assessment because there has been none for that year.

Those are the only two years involved in the credits in this particular account.

My testimony yesterday, I think, went to the fact that upon a final determination, this amount was available for whatever disposition the management or the Board of Directors or the stockholders or whoever has the authority to dispose of it sees fit to make of it.

Q. Yes. Your statement is that so far as you know, up to the present date, there has been no disposition of this particular reserve?

A. That is correct and it may be we may decide it is a possible cushion for possible taxes which would be normal for an organization such as ours to preserve. I am not

[fol. 6460] predicting that will take place but I am saying that is an eventuality.

Q. Would not the fact of any elimination of this account in its entirety or in part result in an increase in the net income of the company during the years when such amounts were set aside?

A. I should think not. We went over the ground yesterday with respect to what the company's accounting policy has been with respect to such adjustments.

The normal procedure that we would follow, I believe, would be to restore whatever amounts ultimately remain of the $624,000 to surplus rather than to take it through income.

Q. Yes, you mean that you would handle this account in the same manner which you indicated yesterday you would handle any excesses in the account for taxes accrued as shown at Line 16?

A. Yes, I think that is correct and I believe such plan would be generally in conformity with "Instructions—General" included in the Federal Power Commission's Classification of Accounts for natural gas companies.

At any rate, if it did affect income, it would affect it before regulation overtook us.

Q. Can you tell us, Mr. Watkins, what is represented by the account shown at Line 38, "Contributions in Aid of [fol. 6461] Construction"?

A. I observe at Page 30 in the Federal Power Commission's Classification of Accounts prescribed for natural gas companies subject to the provisions of the Natural Gas Act effective January 1, 1940, an account, No. 241, the title of which is "Customers' Advances for Construction".

Generally speaking, the amounts to which you refer fall in the general category of the explanation to the account in the Power Commission's Classification just referred to.

I cannot give you the detail as to whose advances they were or exactly what the advances were for but the purpose coincides with the instruction in No. 241 in the Classification.

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[fol. 6464] Q. Mr. Watkins, as Controller of the company you are charged with the responsibility, are you not, of reporting balance sheets and other similar statements showing as accurately as possible the financial position of the Panhandle Eastern Pipe Line Company?

A. Even were I not so charged, that is exactly what I would do to the best of my ability.

Q. That is one of your responsibilities, is it not?

A. I think it may be prudently said that it is.

Q. And is the balance sheet so prepared by you a financial report of the Panhandle Eastern Pipe Line Company and its subsidiaries?

A. Are we now referring to Exhibit No. 48 of this proceeding?

Q. Yes, that would be necessarily—

A. (Interposing) That means all of the periods covered by that exhibit?

Q. That is correct. A. They are.

Q. And such balance sheets are designed, are they not, [fol. 6465] to give information and a financial report to all interested parties?

A. That is correct, to the extent that they are available for general distribution.

Q. Do the balance sheets show the status of each equity in the business of the company?

A. With respect to Panhandle Eastern's affairs?

Q. Yes. A. I think they do.

Q. Yes.

And, consequently, it is of marked significance to those who have invested capital in the enterprise or to those who are contemplating the investment of such capital, is it not?

A. There has been no opportunity for such investments. Generally, prior to the year 1939, other than in the sale of senior securities in the form of funded debt.

There is a Registraiton Statement pending through which some substantial holdings may develop in equity securities and it is the witness' belief that to the extent that a prudent investor may wish to measure the affairs of the company any information, including balance sheets, which Panhandle Eastern Pipe Line Company prepares and distributes for that purpose may be relied on entirely by the investor.

Q. Yes.

[fol. 6466] A. When we speak of "investor" here, I presume we mean possible or potential or proposed investor?

Q. That is correct. And is the balance sheet, also, of marked significance to the management because it represents the standing or the condition of the business by presenting a periodic statement of assets and equities?

A. From an operating standpoint, sir, I should think we would treat the income statements with a great deal more significance than the balance sheet, itself, necessarily, however, they both form mediums through which management, owners, the public or anyone else can draw certain conclusions and make certain measurements of the status of the company at any date certain when such information is made available or for any periods for which such reports or statements speak.

Q. Yes, but, of course, the income statement does not show the assets and equities in the business?

A. Well, if my remarks were such that one would infer that the income account did make such shownig, they should be corrected to the extent that you have indicated.

I believe what I stated was that the income account from an internal company standpoint would probably have as much, if not more, significance to us than the balance sheets, themselves.

Q. Yes.

[fol. 6467] Now, is it necessary for the management to consider the relationship of the assets and equities in the business in determining the actual working capital situation?

A. Mr. Gorman, I doubt that I am qualified to discuss working capital with you to any great extent.

Q. Well, by that do you infer that you are unable to answer the question I have propounded?

A. I do not quite understand just what you mean. Let me see if I can give you an answer that is satisfactory. If we are thinking, when we speak of working capital, of the funds the company needs to carry on its day-by-day operations, to take care of any construction program it may

have authorized, to take care of any construction program which may be anticipated, to provide funds to pay taxes and to have on hand sufficient cash for any and all other purposes that it may find necessary during the course of its operations my answer would be that certainly we must take into consideration all of the information available not only from the books and records but elsewhere.

Q. Yes. Of course, the balance sheet is a reflection of certain of the books and records of the company?

A. Well, doesn't it epitomize the entire books and records of the company, so to speak?

Q. Well, I think so, yes. I did not know whether you wanted to go so far or not.

[fol. 6468] A. Well, I stand solidly, sir, behind any of the statements that have been prepared with respect to the company and submitted here through me.

Q. Is the balance sheet considered by the management of showing the relationship of assets and equities in determining the amount available for the payment of dividends?

A. The balance sheet, alone, would not necessarily be subject to such considerations. The first move we make, very naturally, with respect to dividends is to find what our legal hurdles are.

We must consider the laws of the State in which we are incorporated. We must then turn to our Articles of Incorporation to find what restriction, if any, there is there that is superimposed over and above the laws of the State.

I do not mean by that that our Articles of Incorporation can be in violation with the provisions of the general corporation laws of the State of Delaware. We must, also, have a look at our mortgage and deed of trust, we must turn to our note indenture, we must think something of whether or not the funds that we might otherwise use for the payment of dividends would serve a better purpose in the interest of the public, the investor or the consumer and a vast number of other elements go into our consideration of a matter of this sort.

Q. Including the balance sheet?

[fol. 6469] A. Oh, very naturally, we think of the balance sheet.

Q. Well, does not your statement of earned surplus, as qualified by the note contained on Page 3, that is Note 2 on Page 3 of Exhibit No. 48, reflect all restrictions which are placed upon your disposition of earned surplus?

A. Not all of them, no sir. It reflects the one restriction which is applicable at the moment. As the witness explained yesterday, there is a restriction in the Certificate of Incorporation running to the amount which must be set aside in determining—now, when I say "set aside" here I do not mean as per books—the amount of earned surplus under certain conditions available for dividends.

So long as the restriction in the mortgage and deed of trust exceeds that restriction, then the mortgage restriction is applicable.

Q. I see. And if, perchance, the securities covered by Registration No. 2-4919 were to be issued with restrictions which imposed greater barriers than those now in existence, they would be controlling?

Ordinarily, in issuing a balance sheet statement, do you qualify the issuance of such statement not only by the Note No. 2, which is on Page 3 of Exhibit No. 48, but, also, append the note to such balance sheet the qualifications of the Articles of Incorporation to which you have just made reference?

[fol. 6470] A. There has been, no annual report released by the company since the mortgage and deed of trust dated November 1, 1940, was consummated in February of 1941.

Unquestionably if and when we do release an annual report, we shall see that the public is fully informed as to any restrictions that we may have.

The annual report for the year 1940, a copy of which I show you, carries a balance sheet note on Page 10 with respect to the restriction of surplus as provided by the Certificate of Incorporation.

We hope we shall always be cautious enough to see that any information we prepare and release for the public is sufficiently qualified to avoid any difficulty for the public, the investor or the company.

Q. Yes, and of course, as we have seen previously, such notes have been appended to balance sheets containd in Registration Statements and made an integral part of such statements as they are filed before the Securities and Exchange Commission. Is that correct?

A. That is correct, sir.

Q. Now, does the management consider the relationship of assets and equities as reflected on the balance sheet in determining the programs for expansion of facilities or the raising of capital to be used by the company?

A. Mr. Gorman, we have this situation in our organi-[fol. 6471] zation:

We have a go-getter who expands property and then tells us to worry about how we are going to get the funds.

Q. You mean—does that intend to indicate that this individual gives no consideration to the—

A. (Interposing). Oh, no indeed, sir, his primary purpose is to develop the properties to their full economic potentialities.

The predominating thought in his mind—and I think that is more or less true with the whole organization—is, "let's get this job done and then let's get busy and pay for doing it."

As a matter of fact, we have to pay for it before we do it, but we approach it, perhaps, from a slightly different angle than it might be with someone else or even some other organization.

Q. I see.

A. That does not mean to say, sir, that we do not eventually give consideration to everything that should be given consideration. I merely state that the order is slightly different and it is a rather refreshing way to do things, if I may say so.

Q. Yes, I can understand that. Of course, assuming that I know who the individual is, I rather gather the impression that he is undoubtedly familiar with the as-[fol. 6472] sets and liabilities as reflected on the balance sheet anyway, without a detailed study of such sheet?

A. That is quite correct, sir.

Mr. Wheat: Well, Mr. Watkins, you do not want to keep it a secret whom you are referring to, do you? You are referring to the President of the company?

The Witness: That is right. I did not think it was necessary to name names. I believe the individual is quite well known to everybody in the hearing room here.

Mr. Wheat: I was afraid that, on the cold record your meaning might not be apparent.

The Witness: Well, for the benefit of posterity, then, we are referring to Mr. J. D. Creveling.

By Mr. Gorman:

Q. Is it essential in any planning for the issuance of long-term securities, is it necessary to consider the disposition of equities of the company?

A. Let me see if I understand that. Do you mean the proportion of senior securities, junior securities and so forth as to the total capitalization?

Q. That is right.

A. I believe you will find, if you care to observe the record, quite a considerable amount of data that would indicate that such consideration has most recently been given with respect to applications that were pending be- [fol. 6473] fore the Securities and Exchange Commission in its Consolidated Docket No. 59-33 and if there be further interest in the matter, I might refer you to the material which you will find in the copies of Form U-1 in File No. 70-387 and Amendments 1 to 5 thereof which have heretofore been delivered to you.

Mr. Wheat: When you refer to Form U-1, you refer to a form of the Securities and Exchange Commission, do you not?

The Witness: A form filed in the matter designated by the Securities and Exchange Commission's File No. 70-387.

Mr. Wheat: Thank you.

By Mr. Gorman:

Q. So the answer to my question, briefly stated, is "yes"?

A. Oh, surely we give consideration to the avoidance of overloading our capital structure with a type of security that is going to rise up to haunt us when business conditions are different from what they are at the moment.

Q. Does the balance sheet show the equities of the owners and the creditors and the assets of the business?

A. From the company's standpoint or from the investors' or owners' standpoint?

Q. From the standpoint of anyone who examines the balance sheet for the purpose of determining such information.

A. On the basis of the balance sheets, themselves, they do give such a reflection. I am laboring with the fear [fol. 6474] that you are asking me to say that if I were an investor in Panhandle Eastern Pipe Line Company or a major owner of some of its equity securities, that my personal feeling or evaluation of my ownership in Panhandle Eastern Pipe Line Company would be exactly reflected by any equity determination made from its books.

If that is the purpose, I shall have to say that my view would be "no".

Q. Well, by that you mean, can you divide up, on the basis of the balance sheet information, the equity of a bondholder as distinguished from the equity of a common-stock holder and such things as that?

A. Not only that, sir, but I might have an entirely different view of the worth of my investment in any corporation than that which could be reached by simply referring to cold facts and figures taken from its records.

Q. Yes. Well, let me put it this way: Does the balance sheet show the combined equities of the owners and creditors in the assets of the business?

A. As reflected by the company's books, yes.

Q. Yes.

A (Continuing) For any other consideration which the owners might wish to give, I do not consider it as making any such showing.

Q. Yes. Well, of course, we understand that at all [fol. 6475] times the balance sheet is, as was stated before, merely a reflection of the books, themselves?

A. Then, we seem to have a meeting of minds as to this particular thing.

Q. Yes, that is right. And, as we stated before, the balance sheets have been in the past, and in the very recent past submitted to and made an integral part of Registration Statements filed with the Securities and Exchange Commission?

A. Not for all periods represented by the company's operations, no.

Q. I did not say throughout the years.

A. To the extent that the periods were applicable at the time the Registration Statement was filed, yes.

Now, there has been a constant audit of the company's affairs and its balance sheets have been certified to from its very inception by independent public accountants.

Q. And it is also true that, generally speaking, the management bases its decisions upon data set forth upon the balance sheet?

A. Not altogether, no.

Q. I say "generally speaking".

A. Well, the management gives consideration to the information shown in the balance sheet, certainly but there are so many other things other than cold facts and [fol. 6476] figures and records that must be treated with in most everything that we do that this witness could not agree that that would be a proper statement.

Q. Yes. Well, of course, we all understand that the management also considers other reports in connection with the information set forth on the balance sheet.

I merely intended to indicate that that is one of the main objects of their study.

A. It is one of the objects of their study, not necessarily the main one.

Q. One of the main ones, I said.

A. O. K.

Q. And, of course, in the past, as I think we have seen from an examination of certain Registration Statements, public accountants have on occasions certified to the financial position of the company as disclosed from the balance sheets, have they not?

A. They have.

Q. And can it be properly said that the balance sheet per books is the presentation of the general ledger accounts

and is, so to speak, the master control of the books and records of the company?

A. I would hardly characterize it as a control. Any balance sheet, it would seem to me, is simply a statement prepared from the books of the company. I do not know [fol. 6477] to what extent it could [—] said that a balance sheet controls the books.

Q. Well maybe we should put it this way, Mr. Watkins:

It does reflect the general ledger, which general ledger shows the control accounts?

A. That would be correct, yes.

Q. Mr. Watkins, the presentation of this Exhibit No. 48 for identification in this proceeding, was it done for the purpose of representing to the Commission the financial position of the company and the equities of the owners and creditors in the assets of the corporation?

A. I do not know that I remember that at the time that we were planning to present an exhibit showing the balance sheet of the company for the periods shown by Exhibit No. 48 that we had any particular discussion as to what purpose it would serve in the proceedings other than the fact that the Federal Power Commission would likely want it for the entire periods and here it is.

Q. Yes. If you had that particular thought in mind, you would have presented a balance sheet, which would not differ from that which is presently identified as Exhibit No. 48, would you not?

A. I do not know, sir. I would have to go back, I suppose, to the time that we were doing all this work and try to evaluate what the purposes were and how the information could best be shown and what time we had in which to [fol. 6478] prepare the exhibit.

If I remember correctly, we threw a tremendous mass of information together here for you in the space of a very few weeks upon not too great notice. My personal decision might have been one of a half-dozen approached from 40 to 50 different ways.

Q. Do you know of any reason at the moment why the balance sheet presented with such a thought, as I have indicated, in mind would have differed in any respect from that which is presented as Exhibit No. 48?

A. I have not given any thought to the matter, really.

Q. You have no thought of any differentiation?

A. None that I would care to express at this moment.

Q. You, of course, have no doubt at the present time that the balance sheets, as reflected on this Exhibit 48, properly reflected the position of the company for the various years shown thereon?

A. Not the slightest.

Q. Mr. Watkins, do you presently have any intention of revising the balance sheet in any manner which would change it from that which is shown on Exhibit No. 48?

A. If it were so revised, the facts would not change.

Q. Well, that does not exactly answer my question. Do you have presently any intention of making any revision?

A. Do you mean for internal purposes?

[fol. 6479] Q. For any purpose.

A. It is my remembrance that when and if our proposed securities are registered with the New York Stock Exchange and are registered under the Securities and Exchange Act of 1934, we must give some indication as to the manner in which our annual reports, our certified annual reports, if I recall, are required by both the New York Stock Exchange and the Securities Act of 1934.

To the extent that those requirements bring about a different presentation than that shown by Exhibit No. 48, such changes will be made.

The witness has not made a comparison of the proposed balance sheets in the new form of annual report.

Mr. Wheat: You are referring now to the Federal Power—

The Witness: (Continuing) Prescribed by the Federal Power Commission in its Order No. 86, so that he is not in a position to state even as to that whether it will require a restatement of the assets and liabilities in any form other than that shown by Exhibit No. 48.

Further than that, we haven't any particular view with respect to the balance sheets. They seem adequate to us.

By Mr. Gorman:

Q. Yes. Well, of course, any such changes would be minor in character and, also, would be only in form rather than in effect, would they not?

[fol. 6480] A. I do not believe I understand that you are inferring that a formal balance sheet could change the effect as of a date certain?

Q. No. The point I wanted to make is certainly clear here.

A. Well, we seem to be in the same bed there.

Q. Well, we seem to be getting there quite often.

A. Mr. Gorman, before we leave the subject, if you please, the witness does not know of any restriction whereby a corporation can not present its balance sheets in any form it wishes if making such a balance sheet for any purpose other than the specified one under certain stipulated conditions. We are not in disagreement there, are we?

Q. Oh, I think not.

Have any representatives of the company, that is the Panhandle Eastern Pipe Line Company, or expert consultants employed by that company presented any information or opinions which would cause you to revise or restate the equities or assets as shown in the balance sheet?

A. By "restatement" do you mean change them, change the amounts either upward or downward?

Q. That is right, change the—

A. (Interposing) Why, I would not have any authority to do such a thing, sir. As Controller of the company and as its Secretary and an officer of the company and as a [fol. 6481] prudent individual, why, I would be astonished if anyone offered any such suggestion as that.

Not only would I be astonished, I think I would more than likely beat the stuffing out of them.

Mr. Wheat: I wonder, Mr. Gorman, in connection with that question, which I think is as unintelligible to us as it apparently was to the witness, whether you could define what you mean by "change" in the balance sheet or items of the balance sheet?

Mr. Gorman: Well, of course, counsel recognize the general terminology of the word "change" means substituting something for that which previously existed or presently exists.

Mr. Wheat: You mean renaming some account or changing its name?

Mr. Gorman: Well, I thought I said "in amounts" or, if I did not, at least that was what I meant, that is, changing the amounts which are shown on the balance sheet to reflect some other amount.

Mr. Wheat: You mean a substitution of one item for another, is that what you are asking the witness?

Mr. Gorman: Well, by "item" I do not suppose you mean an account designation. I am speaking of the amounts reflected.

Mr. Wheat: No, I meant to take $1,000 out of the ac- [fol. 6482] count on Line 18 and put it into the account on Line 19. Is that the kind of a change that you meant?

Mr. Gorman: Either that or take $1,000 out of one account and not put it in another account.

The Witness: Well, maybe I misunderstand. If you are talking about any corrections that might have to be made, I would ask nobody about any proper correction, I would simply make the correction.

When I say "correction" there, I mean if we find an improper charge to a wrong account.

By Mr. Gorman:

Q. Well, that is merely an adjustment.

A. If you are directing your question toward improper procedure, I do not have to work for Panhandle Eastern Pipe Line Company, if it ever gets to a position where we are doing some things that are illegal.

I can still starve, sir, before I encounter a situation of that sort.

Q. Well, of course, now, Mr Watkins, I do not think there was any reflection of any kind whatsoever. That was not intended by my question.

Mr. Wheat: Mr. Gorman, if you have any idea of any misplaced items, I know we would appreciate it if you would suggest them.

I know the witness would be the first one, if he knew [fol. 6483] something was wrong at same place in the balance sheet, to correct it. He has stated that he does not know of any such.

Mr. Gorman: That was the answer to my question. I have no such thought in mind. I am not proposing any adjustments, I just asked if any such adjustments had been proposed.

By Mr. Gorman:

Q. Has there been proposed any modification of the equities, as shown on the balance sheet, by the President and the Chairman of the Board of Directors or the Board of Directors, themselves?

A. We have no Chairman of the Board of Directors and as to any such proposels with respect to the Board, itself, or to the President, the witness must confess that he does not quite understand what you mean.

Q. Well, do you know of any modifications whatsoever that have been proposed?

A. The Board of Directors, generally, does not have any direct contact with the record, that is in the keeping of the records of the company, and our President has not, to my knowledge, suggested to anyone that any of the accounts be changed in any manner whatever.

If they are not right, he takes the heads off of us and if they are all right, that is the way we should have them [fol. 6484] in any event.

Q. Well, of course, Mr. Watkins, without quarreling with you whatsoever, I believe you previously testified, did you not, that the Board of Directors annually passed upon at least the reserve accruals for that year?

A. Oh, surely, with respect to the matters of policy, naturally.

Q. And, of course, those are ultimately reflected in the balance sheet?

A. Some of them have to be, directly or indirectly.

Mr. Gorman, is this the thing that your most recent line of questioning is directed at, do I know of any instance during the time I have been associated with Panhandle Eastern or most recently where any member of the Board of Directors, or the President of the company or anyone

else connected with the company in authority may have expressed some view that some phase of the company's accounting did not correctly represent conditions that had actually transpired or were present that particular moment?

Q. No, as a matter of fact, definitely to the contrary. We are not intimating any impropriety in any past actions of the company or officials.

A. Well, I asked my last question with the view of trying to get to the point that you were driving toward.

Q. Yes. Of course, I think you will readily recognize [fol. 6485] that all of the questions I have previously asked tend to emphasize by the answers given thereto on your part the importance and accuracy and propriety of the balance sheet statements as contained in Exhibit No. 48.

A. Oh, they are accurate, there is no question about that.

Mr. Wheat: I think the simple question, Mr. Gorman, of the witness is whether he stands on the balance sheets as shown in Exhibit 48.

The Witness: And if such a question were put, the answer would be "implicitly."

By Mr. Gorman:

Q. Well, we so understand. We just want to find out whether everybody stands on it as well as Mr. Watkins does.

Mr. Wheat: Well, he cannot answer for other people except as they may have expressed themselves to him, if they have.

By Mr. Gorman:

Q. Do you, Mr. Watkins, know of any presently proposed changes which will materially affect the financial position of the Panhandle Eastern Pipe Line Company?

Mr. Wheat: Changes in what, Mr. Gorman, just to clarify your question. Changes in its capitalization or changes in its operations?

Mr. Gorman: Well, I think it would include all of those, [fol. 6486] most certainly changes in equity or changes in assets would affect the financial position of the company.

The Witness: Could we limit that to the things that would normally happen to an organization?

Mr. Gorman: I think so.

The Witness: Such as the additional investment in income-producing properties?

Mr. Gorman: That is what I had in mind.

The Witness: The change of the character of its capitalization and things of that nature?

By Mr. Gorman:

Q. Yes. What I have in mind, particularly, Mr. Watkins; is any present plans underway or proposed plans which will materially change the position of the company as evidenced by the balance sheet at June 30, 1941, which is the date shown on Exhibit No. 48?

A. I wish I could answer specifically as to what our tax situation is going to do to us. All of us know the tremendous load that is going to be put on an organization to help pay for our war activity and, generally speaking, I believe organizations will be happy to pay up to the limit of their ability, providing they pay proportionately.

That will, naturally, make a change. The company, as you know, anticipates the purchase of some additional properties.

[fol. 6487] That will bring about a change. It will add assets, liabilities, income, just what it will do to the net I do not know because there will come along the additional taxes.

If you have any interest in that particular phase of possible changes, take a look at Page 3, I believe it is, of the Prospectus accompanying Registration Statement No. 2-4919.

* * * * * * * * *

The Witness: There are now under construction some $9,000,000 of additional facilities, a portion of which will be income-bearing, a portion of which will simply strengthen the facilities as they now exist.

There may be some considerable additional load available to the company in off-peak periods. It may be pos-

sible that as a result of the control by the National Defense Authorities, whoever they may be or whatever organization in which such activity may ultimately fall, which will result in the placement of our gas available for use in certain directions, that would tend to either increase or decrease our income.

There are so many things, sir, that might ultimately change the operations of the company and, thereby, have some immediate effect on its financial position as re- [fol. 6488] flected by a balance sheet that might be taken at any particular time, that this witness should hate very much to have any obligation thrust upon him to try to define all or even a great part of what potentialities might be in existence.

Now, said differently, at this particular moment I, personally, know of nothing that may tremendously affect the company in an adverse way.

We have found it necessary most recently to increase expenses because of certain conditions. Subsequent to December 7, 1941, we began a very definite program of property protection which brought about the necessity to employ more than 80 additional employees.

The annual cost of that addition, expressed in payroll, and any other expense that may result from it might range around $175,000 a year. Whether that shall be increased or decreased is something that this witness cannot answer.

My judgment is that as long as our world conditions remain as they are, we may look for an increase. We hear a good deal and read some in the papers about the possibility of a change in Social Security Laws, making necessary additional contributions on the part of the employers.

We see evidence every day of increased costs. Only yesterday morning, I believe it was, this witness noticed that railroad fares would be increased 10 percent. You [fol. 6489] hardly turn, toward the purchase of anything, either necessities for one's life or necessities used in connection with operation of an industry but what you do not bump into an astonishing increase in costs.

Certainly I am not crystal gazer enough to answer your question any more than I have in this general way.

* * * * * * * *

Q. Well, that is quite satisfactory.

Now, Mr. Watkins, if the assets or equities as reflected in the balance sheet submitted by you are modified by representatives of the company or experts employed by the company for the purposes of this proceeding, do you propose to present a revised balance sheet or make any revision in your balance sheet to show the financial position of the company after giving effect to such changes?

A. Well now, sir, there is not going to be any expert that modifies any balance sheet that this witness submits, if I understand your use of the word "modification".

Q. That is correct.

A. Now, if your question means this:

Suppose, for instance, Panhandle Eastern has employed some expert for use in connection with these proceedings or, suppose, for instance, some of its officers or employees used by this witness in these proceedings placed some different interpretations on the balance sheet or any of the [fol. 6490] items disclosed by the balance sheet, then because of the factual interpretation that can be placed on the material included in Exhibit No. 48 does this witness intend to present another balance sheet giving expression to those modifications? Is that what we are talking about?

A. I should say, sir, that the answer would be most definitely "no".

Now, it may very well be that before these proceedings have been consummated that additional balance sheets with respect to Panhandle Eastern Pipe Line Company may be required.

There are certain transactions in the process of consummation, we hope, that would give rise to considerably more assets and considerably more liabilities. They would, likewise, change the income position.

It is my belief that the Commission will wish to be fully informed as to that condition, if it ever exists.

Q. ~~Such a condition would,~~ would it not, Mr. Watkins, change the balance sheets which are shown on Exhibit No. 48?

A. They might, for this reason: If the interpretation of the acquisitions which are contemplated is such that Panhandle Eastern Pipe Line Company becomes the owner of those properties on a date certain, shall we say as of September 30, 1941, it might very well follow that a proper presentation of the combined picture would be such [fol. 6491] as to require a consolidation of balance sheets and income statements prior to June 30, even.

Now; it may be that I misunderstand. In making such a consolidation the facts as shown by Exhibit No. 48 would remain unchanged.

Q. Yes. You are only taking into consideration the eventuality that a retroactive effective date to such an arrangement would provide additional items over and above those which you have presently shown?

A. That is correct.

Mr. Gorman: Mr. Examiner, I have here a statement entitled, "Panhandle Eastern Pipe Line Company, Statement Showing Investments Made by the Owners and Long-Term Creditors at June 30, 1941."

May this be numbered for identification as an exhibit, please?

Trial Examiner: This will be marked for identification as Exhibit No. 149.

* * * * * * * * * * *

Q. Now, for the purposes of the record and to clarify this statement in your own mind, Mr. Watkins, if you will bear with me, I should like to determine the source of each of the figures which are shown on this statement which has been identified as Exhibit No. 149.

[fol. 6492] Will you refer, please, to the heading "Plant Assets" and the subheading, "Gas Plant", which is shown to be a total of $66,689,669.57?

This, is it not, is the figure which is shown at Column M of Line 1 of Exhibit No. 48, Page 1?

A. It is.

Q. And is the next item "Contributions in Aid of Construction" the amount shown on Page 2 of Exhibit No. 48 at Line 38?

A. In Column M?

Q. In Column M, yes. A. It is.

Q. Is the next item, "Reserves for Depreciation and Depletion" in the amount of $10,135,513.92 shown in Column M of Page 2 of Exhibit No. 48 at Lines 28 to 33, inclusive? A. That is correct.

Q. And without asking you to make the addition, we will assume, subject to anyone's check, that the amount of $56,512,808.74 represents the amount of $66,689,669.57 less $41,346.91 and less $10,135,513.92 and is the total shown opposite the heading, "Net Investment in Gas Plant".

Now, the next item, "Other Investments" in the amount of $214,298.25—

A. (Interposing) Pardon me, sir, that assumption simply goes to the total and not involving any of us in an [fol. 6493] assumption that it is what it is stated to be here.

Q. Well, yes, I am speaking now only of the mathematical calculations.

The amount of $214,298.25, shown as being "Other Investments", appears on Page 1 of Exhibit No. 48 in Column M at Line 3, does it not?

A. It does.

Q. And does the amount of $9,990,919.84, shown as being, "Current and Accrued Assets" appear at Column M, Page 1 of Exhibit No. 48 at Line 15?

A. It does.

Q. And does the amount of $5,149,111.73, as shown here as representing "Current and Accrued Liabilities", appear at Lines 20 and 21 of Page 1 of Exhibit No. 48 in Column M?

A. It does.

Q. And this exhibit indicates, does it not, that the deduction of the latter figure from the one previously named produces a result of $4,841,808.11?

A. It does.

Q. And is the amount shown as "Deferred Debits", totaling $2,763,002.03, shown at Line 24, Column M of Page 1 of Exhibit 48? A. It is.

Q. Is the amount shown as "Deferred Credits", total-
[fol. 6494] ing $43,333.69, shown at Line 26, Column M of Page 2 of Exhibit No. 48? A. It is.

Q. And is the "Reserve of Uncollectible Accounts" in the amount of $44,819.88 reflected at Line 34, Page 2 of Exhibit No. 48, Column M? A. It is.

Q. And is the amount of $93,123.74 reflected as "Reserve for Injuries and Damages" shown at Line 35, Column M of Page 2 of Exhibit No. 48? A. It is.

Q. And is the "Reserve for Contingencies" in the amount of $624,800.94 shown at Line 36 of the same column and page of this exhibit? A. It is.

Q. And, of course, "Total Other Assets, Liabilities et cetera", in the amount of $6,798,731.89 has not, as yet, been checked by you? A. It has not.

Q. Nor has the total under this heading of "Other Assets, Liabilities, etc.," of $63,525,838.88 been checked by you?

A. It has not nor have any of the additions or subtractions shown on Exhibit No. 149 been verified by this witness.

[fol. 6495] Q. Yes. Now, under the main heading of "Net Equities of Owners and Long-Term Creditors" there appears under the subheading, "Long-Term Debt", an amount of $23,267,543.80.

Is this amount shown in Column M, Page 2 of Exhibit No. 48 at Line 8? A. It is.

Q. And is the amount of $20,184,175 representing "Common Capital Stock" shown at Line 2 of this same page of this exhibit? A. It is.

Q. And is the amount of $11,000,000 representing "Preferred Capital Stock" shown at Line 3 of the same page of this exhibit in Column M?

A. It is and the sum of those two items I will agree, is $31,184,175.

Q. And the "Earned Surplus" in the amount of $9,074,120.08 is shown at Line 41, Column M on Page 2 of Exhibit No. 48, is it not?

A. Not only there, sir, but at Line 41 in the same column on the same page of the same exhibit.

Q. Yes. And the total "Capital Stock and Surplus" would be represented by the addition of the two figures which we have just read which result on this proposed exhibit in the total of $40,258,295.08.

[fol. 6496] Assuming that to be an accurate addition, that does, does it not, represent the total capital stock and surplus outstanding?

A. Under such an assumption, it does.

Q. And assuming the addition which appears on the next line resulting in the total of $63,525,838.88 to be correct, that does, does it not, represent the total net equities of owners and long-term creditors?

A. It does.

* * * * * * * *

[fol. 6497] Q. Mr. Watkins, is it correct to conclude, either from this Exhibit 149 or from Exhibit No. 48, that as of June 30, 1941, the equity and investment by the holders of long-term debt amounted to $23,267,543.80?

* * * * * * * *

The Witness: It is correct to assume that the $23,267,543.80, to which you have just referred, represents the balance of the unpaid long-term debt of Panhandle Eastern Pipe Line Company at June 30, 1941.

By Mr. Gorman:

Q. Does that conclude your answer, Mr. Watkins?

A. Yes.

Q. What about the answer to my question?

A. To the extent that there may be provisions in any of the instruments which the long-term debt is created, imposing definite payment obligations or preferences as to the assets of the corporation, whether they be gross assets or net assets, this amount, $23,267,543.80, would represent a preference on the part of the holders of that debt as to such assets.

Q. Does that make any distinction between the invest- [fol. 6498] ment and equity of the holders of this long-term debt?

A. I do not know whether it does or not.

Q. Are you attempting to make any distinction?

A. I am not attempting to state that a specific equity, as concluded to be such by the holders of securities, can definitely be determined from the books or records of a corporation.

Books and records of a corporation do not represent value. Values, it seems to me must be known before equity can be determined.

Q. Does that represent the equity and investment, as stated in dollars?

A. The amount $23,267,543.80, of itself, is not included as a part of the records of Panhandle Eastern Pipe Line Company to represent investment.

Portions of it may have been used for investments. Portions of the funds originally received, when the debt was created, may have been used to discharge certain obligations then existing by way of taxes or for any other purpose so that this witness cannot properly state that the $23,267,543.80 represents anything other than that which it is shown to represent by the balance sheet identified in these proceedings as Exhibit No. 48 and "balance sheet" as stated there means, of course, the balance sheets at the ends of the various periods.

[fol. 6499] Q. As I recall one of your previous statements, you stated that to this amount the holders of the long-term debt had a preference rating.

Is that recollection correct?

A. That is not correct, sir, because my statements were, I believe, to the extent that any of the indentures, under which this long-term was issued, gave preference to either gross or net assets, rather than as you put it.

Q. Yes.

A. As a matter of fact, as you know, a portion of the $23,000,000-odd is represented by first mortgage and first lien bonds which, very naturally, do carry some preference.

Q. Do the long-term notes also carry any preference, or do you know?

A. I cannot answer that properly for you at the moment. I do believe there are some restrictions that make

necessary the payment of notes in advance of either the Series A bonds or Series B bonds.

In effect, one might conclude that that carried some preference as to assets in a liquidation.

Is that a fair statement to make?

Q. I think so. Are the holders of the long-term debt entitled to recover, in any way whatsoever and excluding interest, an amount of the assets of the company which [fol. 6500] would exceed $23,267,543.80?

A. Mr. Gorman, as you might well realize, the indentures, under which the long-term debt in the form of bonds has been issued, is a tremendously large affair. There are probably as many as 300 pages in it.

This witness does not definitely recall all of the provisions of the mortgage. As a matter of fact, when he has needed to ascertain what the specific provisions are, he refers to the mortgage.

There is, unquestionably, in that indenture, certain provisions with respect to the payment of premium on the call of the securities issued under it which could increase the principal amount shown per the books.

To what extent it would increase that portion of the $23,000,000 represented by bonds, which is $18,250,000 at June 30, I am not prepared to answer you at the moment.

Mr. Wheat: There may be other items, such as expense of litigation and collection and so forth that may be covered? I am not suggesting there are but most indentures do.

The Witness: I presume, sir, that there are such provisions. It occurred to me, when the indenture was being prepared, that it certainly nailed the company in every way that the investor could possibly wish to have it nailed down and provided for all the exigencies or contingencies that could be provided for and further it has, of necessity, [fol. 6501] been made to conform to the Trust Indenture Act of 1935, which, per se, takes care of the public and investors.

By Mr. Gorman:

Q. Well, Mr. Watkins, if this amount to which we have just been making reference does not represent the investment of the holders of the long-term debt in the Panhandle Eastern Pipe Line Company and its subsidiaries, can such an investment be determined by a reference to the balance sheet?

A. Mr. Gorman, I do not believe that I have stated that the principal amount of the bonds shown by the balance sheet did not represent the investment of the investors in those bonds.

I would have no way to know that. Panhandle Eastern Pipe Line Company sold the bonds, received certain proceeds from them; the bonds were, in turn, sold by an underwriting group to the investors.

There may have been some intermediaries between those transactions and whether you happened to have been one of the investors and you paid $110 for something we sold for $100, or whether you were fortunate to purchase it for $60, you should not imagine I would be able to answer that question.

Q. Well, of course, my question is directed to whether or not it represents their equity and investment in the [fol. 6502] properties of the company as shown by such bonds and notes.

Now, when you get to discussing intermediaries and that sort of thing, of course we all recognize that those kind of transactions deviate from the face amount of bonds or the face amount of notes but, for balance sheet purposes, are those transactions of any importance?

A. Is that a question?

Q. Yes.

A. For balance sheet purposes, they would not be reflected in the company's books because the company would have no knowledge whatever of them.

Q. And, of course, for balance sheet purposes, the face amount of the bonds and the face amount of the notes present the liability of the company to the holders of those notes and bonds, do they not?

A. As to the principal amount of such securities, yes.

Q. Is it correct to conclude, Mr. Watkins, either from this Exhibit No. 149 or from Exhibit No. 48 that, as of June 30, 1941, the equity and investment of the stockholders amounted to $40,258,295.08?

A. Mr. Gorman, this witness has stated repeatedly that, in his judgment, equity, as such, in the hands of an investor or creditor cannot necessarily be determined from [fol. 6503] a balance sheet or balance sheets such as those shown by Exhibit No. 48.

Our books do not and have not been intended to represent value. It does not occur to me that, as an investor or as a creditor, I could ever determine what my equity was in an organization without knowing something about it.

I can, however, take that organization's balance sheet, have a look at its liabilities and assets, make certain deductions and so forth and see what the books say are my posibilities for recovery.

Q. From the statements reflected on this Exhibit No. 149 and Exhibit No. 48 and by an examination thereof, would you conclude that the equity and investment of the stockholders amounted to $40,258,295.08?

A. If I may take the liberty of rephrasing your question, I think I can answer it definitely.

Q. You may do so.

A. If you are intending to ask this witness what his personal view is of the value of the stock and notes of Panhandle Eastern Pipe Line Company, his answer will most certainly be that it is tremendously in excess of any figures that may be determined with respect to such thing from the books of the company.

Q. Now, of course, you must appreciate the fact, Mr. Watkins, and I think my question was predicated upon [fol. 6504] such fact, that we are here, in these questions, dealing with the representations made on Exhibit No. 48 and Exhibit No. 149 and no other extraneous matter.

A. There are no representations, as far as this witness knows, made on Exhibit No. 48 other than a pure statement of the facts as they existed at the dates shown on such exhibit.

You have prepared Exhibit No. 149 or have had it prepared and must have in mind something that you expected

to show and this witness does not have the benefit of the purpose for which you have had it prepared and is earnestly trying to answer the questions you put in the most sincere, honest and forthright manner he can possibly do.

Q. Of course, my questions were in the alternative, considering either Exhibit No. 149 or Exhibit No. 48, and with my suggested explanation that these questions are dealing with the figures shown on these two exhibits, can you now answer the question which I previously put to you?

A. I have answered it.

* * * * * * * *

[fol. 6505] Q. You answered the question as you proposed, by rephrasing it. I am asking if you can answer the question as I originally stated it.

The Witness: Let's have it read again, please.

(Whereupon, the question indicated was read by the reporter as follows):

"Q. From the statements reflected on this Exhibit No. 149 and Exhibit No. 48 and by an examination thereof, [fol. 6506] would you conclude that the equity and investment of the stockholders amounted to $40,258,295.08?"

The Witness: Without binding myself to the $40,258,295.08, I would conclude that their equity was at least that much.

By Mr. Gorman:

Q. Why do you make the exception, because you have not made the addition which results in the figure of $40,258,295.08?

A. Not at all, sir. I believe I would be more willing to accept your figures than you would be willing to accept mine but, as I have stated several times this afternoon, you just do not determine equity from figures extracted from the books.

The books of any corporation do not reflect value at any certain time, if ever, and to determine equity, you must know that and that, sir, will be my answer to your question if you put it to me in the form you have from now until the time I am relieved as a witness.

Q. Would you say, Mr. Watkins, that these figures reflect the equity of the stockholders in so far as the books of the company are concerned?

A. In so far as the books of the company can show equity and on the assumption that the figures in Exhibit No. 149 have been correctly computated and at this mo- [fol. 6507] ment I have no reason to doubt but what that is correct. The answer to your question is "yes".

Q. Yes, and your answer is the same with respect to the investment of these stockholders in so far as the books of the company are concerned, is it not?

A. It would have to be, would it not?

Q. That was my impression. I did not know whether it would be contrarywise or not.

It is, therefore, correct to conclude, Mr. Watkins, either from Exhibit No. 48 or Exhibit No. 149 for identification, that, as of June 30, 1941, the permanent equities invested in Panhandle Eastern Pipe Line Company as reflected by the books of the company and these exhibits amounted to $63,525,838.88, assuming the addition made on Exhibit No. 149 to be correct?

A. We would not quite characterize those amounts as permanent equity, could we, because some of them change constantly. The long-term debt itself is subject to gradual reduction. The amount of earned surplus works upward or downward, dependent upon earnings or appropriations to surplus and it will not be a great while before perhaps our long-term debt will change.

So let us say that, as of June 30, 1941, in so far as it is possible for the books of Panhandle Eastern Pipe Line Company or its subsidiary companies to reflect the obli- [fol. 6508] gations of those companies and the amount of earned surplus at that particular date, it does show an amount of $63,525,838.88.

Q. Of course, I intended, if I did not do so, to confine my question to the situation as of June 30, 1941.

A. I wish to make that qualification particularly because we have had introduced in the proceedings in the last two or three days the fact that the earned surplus, for instance, will be reduced by an amount of something in the neighborhood of $2,000,000—

Q. (Interposing) Yes.

A. (Continuing) By entries being made in the month of December or rather being made in the work for the month of December.

Q. Now, the investment made by the stockholders, bondholders and note holders is represented by plant, property, other investments and other current and accrued assets, is it not?

A. You mean the amount of proceeds Panhandle Eastern Pipe Line Company received from the sale of such securities as represented, in some form, on its balance sheet by either plant, property and equipment, cash, special deposits, accounts receivable, deferred debits reduced by the amount of its obligations?

Q. Yes. A. Then the answer is "yes."

[fol. 6509] Now, as to any representation with respect to what the investment of the investors is, I cannot help you.

Q. Well, of course, in so far as we are getting down to detailed and specific amounts, we are and have been confining our questions and answers to the amounts reflected here on Exhibit No. 48 and Exhibit No. 149 for identification.

Now, assuming the figures and the mathematics applied thereto, as shown on Exhibit No. 149 to be correct, is the net investment in plant property of the Panhandle Eastern Pipe Line Company $56,512,808.74?

A. I do not know that I can concur in the fact that the net investment of a corporation at any date certain, resulting from a simple deduction of the reserve per its books, represents anything other than a mathematical computation resulting in the reduction of the investment as shown by the company's books in its gas plant, since we are dealing with a gas company, of the amount it had at that particular time included as its total reserve for depreciation and depletion, as you have characterized them in Exhibit No. 149.

We have had a very great amount of discussion here today about reserves. The record is replete with the thought that those reserves, at any particular time, may be either quite inadequate or they may be totally adequate

[fol. 6510] or they may be excessive, so that it would be difficult for this witness to state, without some reservation, that the net investment in gas plant as of June 30 could be arrived at simply by reducing the $66,689,000-odd shown in Exhibit No. 149, by the sum of $41,000-odd and $10,135,000-odd.

Q. Well, Mr. Watkins, giving careful consideration to your previous statements of the accuracy of this balance sheet and your statement that you propose no change in the balance sheet as here reflected, does that not, in your opinion, represent net investment in gas plant?

A. I would like to help you, Mr. Gorman, and I should like to be able to answer the question in the manner in which I believe you wish it answered but I must simply say that at June 30 the records of Panhandle Eastern Pipe Line Company and its subsidiary companies show figures which could be used and have been used in Exhibit No. 149 for the determination of what is there characterized as net investment in gas plant but as to whether or not that is definitely the net investment in gas plant for many and varied purposes, I really do not know.

Q. But according to the best information available to you and to other officers of the company and upon the considered judgment of you and other officers of the company and the Board of Directers as reflected in the books and records of your company, that did, did it not, represent [fol. 6511] net investment in gas plant property as of June 30, 1941?

A. It represents what it shows that it represented.

Q. Is that not what it represented as of that date?

A. Is that not what it represented?

Q. Yes.

A. I have stated several times that I do not believe I can answer the question specifically as you put it.

Q. And is that due to the fact that you do not know exactly what precise amounts should be set aside in reserves for depreciation and depletion—

A. (Interposing) That and other things.

Q. (Continuing) May I finish—as of June 30, 1941, because you are unable to look into the future and see exactly what is going to happen there?

A. It is due to that and other things.

Q. Yes, but in so far as these reserves for depreciation and depletion are concerned and as reflected on these exhibits which represent amounts taken from the books of the Panhandle Eastern Pipe Line Company and its subsidiaries they, as you have previously testified, represent the considered and final judgment of the officers and management and Board of Directors of the Panhandle Eastern Pipe Line Company as of June 30, 1941, do they not?

A. I cannot answer, sir, as to the considered judgment of the Board of Directors. I have made no examination [fol. 6512] of them to determine what their considered judgment might be.

I cannot answer as to the officers of the company because I have made no examination of them to determine what their considered judgment might be.

Whom else did you mention?

Q. Others who participate in the management of the companies.

A. I have made no examination of the minds of any others who participate in the management of the company to develop information upon which I might express an informed opinion as to their considered judgment.

Q. Are you referring to your inability, Mr. Watkins, to read the minds of others?

A. No, I believe I said I had made no investigation. I am, of course, not a mind reader.

Q. Well, to go back and reconsider certain of your testimony previously given with respect to reserves and depreciation and depletion, including amortization, did you not so testify that the amounts set aside annually represented the judgment arrived at after consideration by officials and others charged with the management of the company which conclusions were submitted to the Board of Directors of the company and passed upon by them?

A. Yes, I may have said that in somewhat that language. Now, if this will come at all close to satisfying [fol. 6513] your inquiry, let me state, without equivocation or without any mental reservation whatever, that the amount shown by the balance sheet or balance sheets included in Exhibit No. 48 as to gas plant do specifically

represent the amounts which the company or its subsidiaries, over the period of years, have considered as proper charges to such accounts and if they have made no substantial blunders in their classification, would represent actual investment in gas plant and to the extent the reserve for depreciation, either annual or the cumulative amount at the end of any of the accounting periods has been properly computed or rather I should say estimated, it represents an amount which, at that time, is sufficient for the purpose.

Now, if you choose to reduce the amount of gas plant by the cumulated reserves and characterize it as net investment, that, sir, is a matter for your own choice.

Q. Well, may I ask you, Mr. Watkins, if you were given the balance sheet as of June 30, 1941, as such balance sheet is shown in Column M of Exhibit No. 48 and were asked to [determined] from the figures contained thereon the net investment in gas plant property, would you do it in any other manner than as it is shown on Exhibit No. 149?

A. It is quite probable that the first thing I would do would be to reduce the amounts shown by the books of the company as investment in gas plant by total reserves.

[fol. 6514] I would then turn my mind to a determination of what was in both of the items, how it came to be there, and whether or not it was full of bugs—

* * * * * * * *

[fol. 6515] Trial Examiner: Are you unable to answer that question, Mr. Watkins, without qualifications? It is a very simple question, you know.

The Witness: Mr. Examiner, it is most probable the conventional way, the rule-of-thumb way, the everyday-man-in-the-street way of determining that investment is exactly as Mr. Gorman has put the question.

Here we are in a rather involved rate proceeding. The witness suspects that Mr. Gorman is trying to elicit testimony from him that this is the actual value of the assets of the company and the witness can not unqualifiedly state that such condition is present.

* * * * * * * *

[fol. 6516] By Mr. Gorman:

Q. And as I understand the witness' conclusion stated simply so that even I can understand it is, no, he would not. Is that correct, Mr. Witness?

A. You are drawing your own conclusion, sir.

Q. I am asking you whether or not that is a proper conclusion to draw from your answer?

A. That I would not assume that to be net investment?

Q. No, that you would not make such computation upon the basis I have previously indicated in a manner different from that which has been performed on Exhibit No. 149?

A. I do not believe I have given testimony that would indicate that that was my conclusion or, as you stated, the conclusion that I would agree to.

Q. [You] qualification being that you would start looking for bugs?

[fol. 6517] A. Not necessarily, no.

Now, I have tried to answer you as frankly as I can and have stated that the ordinary way, the man-in-the-street way, the perhaps conventional way of casual determination of the net investment would be as you put it.

Q. Yes. Would you conclude from that answer that you personally would do it in a manner different from what you have characterized may be the conventional way?

A. I believe my whole line of answers, sir, indicates that.

Q. By that you mean that you would not accept the figures which are shown on the balance sheet?

A. As net investment.

Q. As computation, Mr. Watkins, if you please, of net investment as reflected on the balance sheet set forth in Column M as of June 30, 1941, on Pages 1 and 2 of Exhibit 48?

A. As a conventional method of determining it and for the everyday use, yes, I would.

Q. Yes, that is what I tried to get you to say.

Now, the other investments in the Panhandle Eastern Pipe Line Company, other than gas plant investments, amount to $214,298.25 at June 30, 1941, as shown in Column M, Page 1 of Exhibit No. 48 at Line 3, do they not?

A. Did you characterize those as "other invest- [fol. 6518] ments" or did you state they were other investments in gas plants?

Q. No, I stated they were other investments than investments in gas plant.

A. There is an amount of $214,295.25 stated in Column M opposite Line 3 on Page 1 of Exhibit No. 48, the complete details of which have heretofore been made a part of the record in this proceeding and the accuracy of which this witness has readily agreed to.

Q. The answer is, therefore, "yes", is it?

A. That the $214.295.25 represents other investments at June 30, 1941—I am only being careful here because I really did not understand the first part of your question and if I had a mental lapse, will you excuse it?

Q. Your last statement is absolutely correct except you did say "295" instead of 298".

A. Let's split the difference.

Q. I was going to correct it in the record so it won't be necessaray to do it later.

If the mathematics applied to the figures shown on Exhibit No. 149 are accurate, the total of other current and accrued items, both debit and credit, amounted to $6,798,731.89, did they not, at June 30, 1941?

A. Other current and accrued assets?

Q. Yes.

A. They did.

[fol. 6519] If there were assets unrecorded or liabilities unrecorded, it would change that figure. I do not know of any liabilities that have not been recorded.

As to the value of the assets, the books do not necessarily show such amounts.

Q. And finally, the total of the plant property, other investments, cash and other current and accrued items at June 30, 1841, amounted to $63,525,838.88, did they not, assuming the additions and subtractions shown on Exhibit 149 to be correct?

A. I think that is correct except that the Exhibit No. 149, as such, does not show a cash item separately.

Q. Yes.

A. It is included, I presume, in current and accrued assets.

Q. Yes, that is right. Of course, we have previously indicated that, I think, to clear that item up?

A. Yes, I believe the record is very clear on that item.

Mr. Gorman: If the Examiner please, I offer Exhibit No. 149 for the record at this time.

Trial Examiner: Any objection?

(No response.)

Trial Examiner: There being no objection to the reception of the computation marked for identification as [fol. 6520] Exhibit No. 149, it will be received in evidence by the corresponding number.

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(Exhibits Nos. 145, 146, 147 and 148 Were Received in Evidence.)

* * * * * * * *

[fol. 6521] By Mr. Gorman:

Q. Mr. Watkins, referring back to a subject which you have previously testified concerning, a reexamination of your testimony particularly at Pages 6209 and 6210, which concern the subject of unamortized debt discount and expense and certain adjustments which have been made to that account, you have indicated that all of the remaining amount in Account No. 140 covering unamortized debt discount and expense has been charged to earned surplus.

Were you in your answers referring only to that portion of Account No. 140 applicable to refunded issues or were you also referring to that portion applicable to presently outstanding issues?

Mr. Wheat: Do you have it before you?

The Witness: I do not have this before me but the whole bag of tricks has been disposed of.

Mr. Wheat: What do you mean by that?

The Witness: All of the unamortized debt discount and expense, either with respect to the refunded issues or with respect to the refunding issues, if you please, if we are thinking now of February 3, 1941, with the adjustments previously referred to in the testimony.

By Mr. Gorman:

[fol. 6522] Q. Now, at Pages 6208 and 6209 of the transcript, it seems that the substance of your answers was that the amounts of $517,772.53 and $304,108.96 representing amounts equivalent to savings and income and excess profits taxes were credited to Account 140, unamortized debit discount and expense, was that correct?

A. There was a total of slightly more than $822,000 credited to such accounts. The two figures you mention were a segregation of that total because there were two accounts involved.

My remembrance is that one had to do with call premium and one had to do with debt discount and expense.

Q. Yes, but those were both credited to Account No. 140?

A. Prior to the charging of the residue in the account to surplus.

Q. Yes. Were offsetting charges to these credits entered in Account 507, taxes, or were the amounts charged to some other account?

A. They were, as the record will show, charged to Account 507.1.

Q. Account 507.1 is, of course, your subdivision of Account 507 as shown in the Uniform System of Accounts for natural gas companies as issued by the Federal Power Commission, is it not?

[fol. 6523] A. It is really a new account which we have raised for the express purpose of receiving these charges. Our title, if I remember correctly, is "Charges in lieu of Federal income taxes and charges in lieu of Federal excess profits taxes."

Q. Yes.

A. That entire transaction was a part of previous proceedings. As a matter of fact, if you will recall, the witness read into the record, in response to your request, two journal entries giving effect to these transfers and what-

ever information you may want with respect to them, I believe is already present.

Q. Of course, your Account 507.1 is your subdivision, is it not, of F. P. C. Account 507?

A. The witness stated that when the entry was first placed in the record; stated that just a few moments ago and reiterates the fact that Accounts 507.1 are Panhandle Eastern Pipe Line Company's accounts created for this specific purpose.

My impression is that the Power Commission's Classification of Accounts permits that procedure.

Q. So that the answer then is "yes"?

A. Three or four times, "yes".

Q. Once was satisfactory.

Mr. Watkins, did you receive a letter signed by the [fol. 6524] Secretary of the Federal Power Commission dated October 29, 1941?

A. I did.

Q. And did that letter—

A. (Interposing) That letter was addressed to Panhandle Eastern Pipe Line Company for my attention as Secretary-Controller.

Q. But you did, in fact, receive such letter?

A. Yes, I have so stated.

Q. Yes. Did that letter in Paragraph 7 on Page 2 thereof request you to furnish—

"A statement to the effect that Account 507, Taxes, for the year 1941 will not include a charge (either directly or through Account 228, taxes, accrued) equal in amount to the estimated saving, if any, in 1941 Federal and State income taxes resulting from deductions to be made for income tax purposes, arising from the financial transactions. In this connection your attention is directed to Interpretation Case No. G-52, issued by National Association of Railroad and Utilities Commissioners, which reads as follows:

"'The tax account (507), should include only provision for actual taxes and the account should not be increased by the amount which would have been paid had the refunding transaction not occurred. In other words, there

was an actual saving in taxes and this saving should be [fol. 6525] reflected in the income statement because it is a fact. It believed, too, that the text of Account 507 does not permit the accounting practice resorted to by the utilities in the illustration cited' ".

Now, are we to understand that your charge to Account 507.1 is contrary to the indicated procedure to be followed in this statement of Paragraph 7 of the letter of October 29, 1941, which I have just read?

A. Mr. Gorman, if you will pardon me, I think we are shooting buckshot at canary birds here. This has been the treatment the witness has described which has been discussed informally with the Power Commissions' Chief of the Bureau of Accounts, Statistics and whatever is a part of his title and, as far as this witness knows, there is no disagreement as to the treatment.

Now, if the thing that is bothering you is the fact that we used Account 507 as a means of raising the new account and you fear that we are going to put out some statements to the public or otherwise characterizing these items as taxes, may I please remove that fear without any hesitancy, because if you will observe the income account consolidated which is made a part of Registration Statement No. 2-4919 at Page S-7, it will be noticed that there is shown there two items under the general heading "Charges in lieu of" and we then follow that by the two amounts applicable as of [fol. 6526] September 30 equivalent to the Federal income or excess profits taxes that would have to be paid had we not had the benefit of such savings.

Q. And those figures to which you have just made reference as reflected in the column headed, "Nine months ended September 30, 1941," are, first, charges in lieu of Federal income taxes—$100,000; and, secondly, charges in lieu of Federal excess profits taxes—$487,000?

A. That is correct.

Q. And did you also mention other items—provisions for income and excess profits taxes?

My recollection of your answer is rather incomplete.

A. That was the $487,000 amount.

Q. And those were the two items to which you made reference a few moments ago? A. They were.

Mr. Culton: And they are explained on Note D, Page S-8?

The Witness: Yes, sir.

* * * * * * * * *

[fol. 6527] By Mr. Gorman:

Q. Are we to understand your books will be closed out on the basis of the entries which you have heretofore discussed and explained, including the entry to your Account 507.1? A. That is correct.

Q. Is it your understanding that the conference with the officials of the Power Commission which I have more or less forced upon you to disclose—

A. (Interposing) Not more or less, sir, I think you have been entirely responsible for it.

Q. I will accept that responsibility for it.

A. And, if you please, let's avoid any further refer-[fol. 6528] ence to it if we may.

Q. Very well.

The reason I am asking is whether or not you were advised in any respect differently from the advice contained in Paragraph 7 of the letter of October 29, 1941?

A. If I was what?

Q. If you were advised to make entries or that you would be permitted to make entries which would be considered favorably—

A. (Interposing) By the letter?

Q. (Continuing) No, advised otherwise than the provisions of this letter.

In other words, to my mind, it would seem to indicate that your charges to Account 507.1, are not in conformity with the suggestions offered in Paragraph 7 of the letter of October 29, 1941, which I have read.

Do you consider that they do conform to such a suggestion?

A. Well, I do not know that I do or I do not.

Here is the situation with respect to the debt discount and expense and its disposition:

We have been conscious all this year of the fact that balance sheet accounts, Instruction No. 6-E of the Commission's Uniform System of Accounts for natural gas companies, placed certain requirements upon us with respect to the continued amortization of the debt expense [fol. 6529] with respect to the refunded issues sometime within the current accounting period.

We had also been conscious of the fact that sometime during the year, it was possible we would find it necessary to create other issues of securities which might give rise to further debt discount and expense.

We were not at all anxious to come to the Commission with a form of application covering the previous situation and then be right back in again within a few months with another application so we, therefore, withheld any such application and much to this witness' surprise when, during his first appearance, he made a statement in the record that had the general tenor that presumed we might be in with an application, forthwith we received the letter concerning which we have been discussing.

Subsequent to that time, we gave further consideration to the debt discount and expense and at a meeting of the Board of Directors, the action described in the record a day or so was taken.

We know of no reason why the treatment we have given to these particular items is not in conformity with standard accounting practices consistently followed, and do not believe it is in disagreement with the Commission's view.

Q. And that is without regard to the provisions of [fol. 6530] Paragraph 7 of the letter of the Commission of October 29, 1941, for I believe you previously stated you did not know whether or not your entries were or were not in conformity with that suggestion?

A. There is no fancy footwork undertaken here. They have all been open and above board. It is in the record in its fullest extent.

The results seemingly harm no one. What more can I say?

Q. And in so far as you know and in so far as your entries with respect to the books and records are concerned, is a concluded matter? A. I think it may well be left that way.

* * * * * * * *

[fol. 6534] PAUL B. COFFMAN, a witness, having been previously sworn, resumed the stand and testified further as follows:

Direct Examination (Continued).

By Mr. Wheat:

Q. Mr. Coffman, since the time when you appeared and began your direct testimony in this matter, have you prepared certain data largely in compliance with certain suggestions and queries of the Trial Examiner during your direct testimony?

A. Yes, I have.

Q. I show you a document consisting of four pages headed on the first page, "Financial Data on Common Stock Issues of Electric and Gas Utilities-Years 1935, 1936, 1937, 1938, 1939 and 1940" and ask you whether that is one of the documents [your] prepared in this connection? A. Yes, sir, it is.

* * * * * * * *

(Exhibit No. 150 was marked for identification.)

[fol. 6535] Q. Mr. Coffman, have you also prepared a document consisting of nine sheets, the first of which is headed, "Earnings-Price Ratios of Common Stocks in Various Divisions of the Utility Business? A. Yes, sir.

Q. And was this prepared in the same connection that I previously mentioned? A. Yes, it was.

* * * * * * * *

(Exhibit No. 151 was marked for identification.)

By Mr. Wheat:

Q. Mr. Coffman, have you also prepared a series of tabulations consisting of four sheets, headed on the first sheet, "Panhandle Eastern Pipe Line Company—Estimate of Federal Income and Excess-Profits Taxes, Apply-

ing Rates Levied in the Revenue Act of 1941 to Net Income for the Year Ended June 30, 1941"?

A. Yes, sir.

Q. Was that prepared in the same connection?

A. Yes, it was.

* * * * * * * *

[fol. 6536] (Exhibit No. 152 was marked for identification.)

By Mr. Wheat:

Q. Mr. Coffman, does the data contained in the exhibits for identification Nos. 150, 151 and 152 comprise the extent of the general data which you prepared in connection with the Examiner's suggestions during your direct testimony? A. Yes, it does.

* * * * * * * *

[fol. 6537] By Mr. Littman:

Q. Mr. Coffman, do you have a copy of your Exhibit No. 65 before you?

[fol. 6538] [Q.] Yes, sir.

Q. Will you please refer to Chart No. 37 of that exhibit, which is entitled, "Dollars Needed Annually by Panhandle Eastern to Provide Service to Customers, a Fair Return to Investors and Restore Invested Capital When Gas Reserves are Exhausted Based on Present Capital Structure."

Is my understanding correct that your term, "Total Dollars Needed" as it appears at the bottom of the extreme left hand side of your Chart No. 37 is synonymous with the term, "Total Operating Revenues" as that term is ordinarily used in an income statement?

A. I would say "Total operating gross revenues", yes.

Q. Is my understanding correct that your terms "Operations and maintenance", "Taxes" and "Return of Capital when gas reserves are exhausted", collectively comprise what is ordinarily termed "Total operating revenue deductions" as used in an income statement?

A. That would be correct, with this further explanation, so there won't be any misunderstanding, that those would be the deductions from gross which would arrive

at the figure that we call "Net available for interest charges, dividends and corporate purposes."

In other words, it is all deductions taken out prior to charges for capital.

Q. And that is ordinarily called "Operating revenue [fol. 6539] deductions" in an income statement, is it not?

A. Well, of course, those terms—

Q. (Interposing) Of a public utility?

A. Generally speaking, that is correct, yes.

Q. And these comprise all of the deductions which you take into account for purposes of this study?

* * * * * * * * *

The Witness: Those varying figures are explained in the preceding charts and, for the purpose of building the total that I call the "total dollars needed" as shown on this Chart No. 37, they were all the figures finally accumulated but they were not the only ones that were considered as shown in some of the prior exhibits—

Mr. Wheat: (Interposing) You mean prior charts in this exhibit?

The Witness: (Continuing) Prior charts in this exhibit because of certain changes that were made and certain considerations were made as I went along in my approach to this problem.

I will answer your question "yes", subject to the things that are shown in the preceding charts in this exhibit.

By Mr. Eittman:

Q. Your answer would be "yes", if I were to confine my question to Chart No. 37?

[fol. 6540] A. No, not exactly, because, as I say, there were other considerations made along the line which in certain cases cause a change in figures for what I call the projected amount as against what was the actual figure for the twelve months ended June 30.

Q. Aren't all of these figures projected figures that are shown in Chart No. 37?

A. They are the accumulation of all of those figures shown in the preceding charts and I want to make sure

that a person [understand] that when they are talking about No. 37 because, after all, it is merely the summary chart which takes into consideration all of the various things that I have shown in the preceding charts in this exhibit.

Q. Chart No. 37 summarizes the conclusions reached by you from the various underlying data which is shown in the preceding charts, is that correct?

A. That is correct, yes, sir.

Q. And in order that I may be certain that I understand Chart No. 37, I wanted to ask whether these amounts shown on Chart 37 and called, "Operations and maintenance", "Taxes", "Return of capital when gas reserves are exhausted" collectively and in total comprise all of the deductions from operating revenue in arriving at the "dollars needed annually by Panhandle Eastern to provide service to customers, a fair return to investors and to re- [fol. 6541] store invested capital when gas reserves are exhausted?"

A. Yes, that is correct.

Q. So that the total of these deductions is what is commonly referred to in an income statement as "Total operating revenue deductions", is that correct?

A. That is correct.

Q. Is my [understand] also correct, Mr. Coffman, that your term "Current capital requirements" as used in Chart No. 37 is synonymous with the term "Net operating revenue" as that term is ordinarily used in an income statement?

A. That is correct. It is the net operating revenue figure prior to interest charges, dividends and such amounts as might be carried to surplus.

Q. Mr. Coffman, I would like to have you refer to Schedule 1 of Exhibit 49, which is the income statement, per books, presented by Panhandle Eastern in this proceeding by its Controller, Mr. Watkins.

Trial Examiner: The Trial Examiner will hand the witness his copy of that exhibit.

(A document was handed the witness.)

Mr. Wheat: Mr. Coffman, you will note that is an income statement covering quite a longer period of time.

The Witness: Yes.

By Mr. L[illegible]tman:

Q. I refer you to this schedule and I will ask whether [fol. 6542] your term "Total dollars needed" is synonymous with the term "Total operating revenues" which is shown in Line 7 of Schedule 1 of Exhibit 49?

A. You are referring now to the gross figure?

Q. I am referring to the term which appears in Line 7, Mr. Coffman, "Total operating revenue"?

A. That is correct.

Q. And am I also correct in understanding that the sum of your "Operations and maintenance", "Taxes", and "Return of capital when gas reserves are exhausted" shown in Chart 37 are synonymous with the term "Total operating revenue deductions" which is shown in Line 21 of Schedule 1 of Exhibit 49?

A. Yes, that is correct.

Q. Am I also correct in understanding that the term "Current capital requirements" as it is used in your Chart No. 37, is synonymous with the term "Net operating revenue", as it is used in Schedule 1 of Exhibit 49 in Line 22?

A. Yes.

Q. Now, your written testimony in the text which accompanies Chart No. 37 in the last paragraph reads as follows:

"As shown in the accompanying chart based on the present capital structure, the Panhandle Eastern Pipe Line [fol. 6543] Company would require a total of $15,520,855 annually to provide service to customers, a fair return to investors and restore invested capital when gas reserves are exhausted".

Is that correct?

A. That is correct.

Q. Which figure, in your Chart No. 37, represents the "fair return to investors"?

A. The figures that are used there in Chart No. 37 would be contained in the last column which totals $5,064,821 and the details of those various items in that column would be explained in the preceding charts as to fair return.

In other words, I merely want to make clear that the specific fair return which I am talking about is not shown, percentage-wise, as you note in that column but the total figure which I show there has been explained in the preceding charts.

* * * * * * * * *

Q. But am I correct in understanding that the amount of $5,064,821 which appears in Chart No. 37 represents the fair return to investors based on the present capital structure?

[fol. 6544] A. That is correct.

Q. And, of course, the details as to your method and manner in arriving at that amount are shown in preceding charts, is that correct?

A. The preceding charts and the tables supporting the individual charts, yes. I mean all of the detailed figures are there, too.

Q. Was the amount of $5,064,821 shown in the cross-hatch bar in Chart No. 37 a fair return to investors of Panhandle Eastern for the year ended June 30, 1941?

A. All the figures that were used to arrive at that result and calculation were based upon the current trends in the capital markets and, therefore, I would say it represented a fair return, if you consider that at the present, that is, in 1941, not this year, Panhandle Eastern would have been required or had it been necessary for them to finance again securities in the market because the figure which I used to arrive at that dollar amount was based upon an investor's appraisal of what investors required if they would make an investment in a particular risk.

I would say that it represented very definitely a fair return to them in 1941.

Q. For the year ended June 30, 1941?

A. That is right.

Q. In other words, is my understanding of your answer [fol. 6545] correct that any amount of net operating revenue earned by Panhandle Eastern during the year ended June 30, 1941, in excess of this amount of $5,064,821 was in excess of a fair return, in your opinion?

A. For the particular period in question, which is 1941, because of conditions in the capital market at the time,

my statement is that at least the total figure shown in the last column in Chart No. 37, $5,064,821 is required and, for that particular time, to me that is the irreducible minimum which the management of this company must have.

Now, whether or not if they receive more dollars that is beyond a fair rate of return, I would not say. I mean there may be more dollars than that there but I say that the irreducible minimum they must have is the figure shown.

That, to my way of thinking, is not saying that if they received more dollars that that is necessarily more than a fair rate of return.

Q. Mr. Coffman, you have referred to this figure of $5,064,821 as a "fair return to investors".

Now, is that or is that not a "fair return to investors"?

A. I say that that is the amount and I think you will find in my statements throughout the written matter in the exhibit I have made mention of it also as an irreducible minimum. I say that that is the amount of cash that [fol. 6546] the company must have per annum if they are going to continue to maintain a position whereby, if they need additional capital, investors in the public market will be willing to have the financing forthcoming. It is a fair return.

At the same time, if they receive more money, I presume that could be a fair return also, to answer your question.

Q. It would be a fair return in so far as the investor is concerned if he received more than $5,064,821?

A. No, it would merely mean if there was more than that, if the investor can be satisfied under the present coverage and is willing thereby to [investmen] further in this company, then if the amount is larger than what I say, I presume he would be equally willing to invest.

On the other hand, I contend that if the amount falls below this, the investor would be very reluctant, if not hestitate entirely, to finance or supply money for financing should this company need it.

Q. I gather from your answer, Mr. Coffman, that any amount in excess of $5,064,821 would be an equally "fair return to investors"?

A. I merely say that it gives the investor more protection and I believe it is true that, so far as investors are concerned, they naturally want the capital they put in any concern sufficiently covered by earnings so that their capi-
[fol. 6547] tal investment is fairly protected.

If they believe they are making an investment or if they think a particular investment they are contemplating is not so protected, they are not going to invest any money at the rates I have used. They will require something higher because they think the risk is greater.

Q. Could you answer my question yes or no, Mr. Coffman?

Will you please read the preceding question and see if you can answer that question yes or no. You have already made an explanation but I wonder if you could give me a direct answer to my question.

(Whereupon, the pending question was read by the reporter.)

The Witness: I should say it might be.

By Mr. Littman:

Q. Would it be?

A. Well, if they feel that they are protected with what they have, if there was something more, I should feel that was also satisfactory to them.

Q. How would you feel about it?

A. I would feel just as I have stated to you. I believe this to be an irreducible minimum requirement. If I could get that or more, I would be willing to invest my money in the particular enterprise, if I had money available for investment.

[fol. 6548] Q. Well, suppose Panhandle Eastern were to earn in the year ended June 30, 1942, the sum of, let us say, $5,564,821 instead of the $5,064,821 which latter figure you have called "a fair return to investors."

Would the amount of $5,564,821 be a fair return to investors?

A. Well, I do not know because the study that I have made here was predicated upon conditions as they existed in 1941 at the time I made the study and, at that time, the relationship of earnings of various companies to the prices of their securities, which is what I call this "Investor's Appraisal of the Risk of Capital", were [maintaning] a particular relationship.

Now, as we know, the *prices* of securities have been altered since that time because of Pearl Harbor and a number of incidents which have caused the prices to go down so I would say I would make the same kind of study that I have already made, finding out what the relationships were and if the result came out the same for 1942 that it did at the date of this study, why, then the excess of $500,000 you are mentioning is just so much additional protection.

Q. And you would consider, under those circumstances, that the additional amount still represents a fair return?

A. Well, I am not saying that, because I made a par- [fol. 6549] ticular study, and arrived at a particular figure under particular conditions at a particular time, and I say that is the amount you must have to attract capital.

Now, if you get more, how much easier it will be to attract capital and so on, I do not know. I make that point because of the fact, if a company has bonds outstanding, for example, one method of arriving at the risk involved in that particular security is to consider, among other things, fixed charges times earnings.

Now, if a bond, for example, has a coverage of 1, 1½ times as against a bond that has a coverage of 3 or 4 times, in our language, we say the quality rating of those two securities is different and they will sell on a different yield basis so that definitely would work into this figure and I cannot say, if you keep pyramiding the $5,064,821 so as the coverage on the senior securities becomes greater and great, the quality classification on those particular securities becomes better and better with the result that investors, looking at such securities in the market, would see their quality rating improve and their yield basis would decline.

Taking that decline into consideration on the figures used to make up this particular resultant figure would have a bearing and change the amount.

Q. And would reduce the current capital requirement? [fol. 6550] A. It would reduce the requirement because it would make it easier, presumably, other things being equal, to sell that particular class of [esecurity] to the general public.

Q. Now, this term of yours of "a fair return to investors" does not seem to have any upper limit, does it, Mr. Coffman?

A. Well, I think that apparently we are talking about different things. As I see it, I was asked to make a study as of a given time, which I did and took all the facts which I thought were pertinent into consideration prior and up to that time.

Now, this figure of $5,064,821 is the figure which I say is necessary based upon those facts.

If you go on to 1942 or any other period you would like to mention and the facts and conditions have changed, as I say, I would like to take a fresh look and see, so that, in specific answer to your question, I would say that my answer is "no", that I am not saying there no upper limit to this at all.

I am sticking to the figure that I have here as being the best of my judgment to ascertain such a figure based on the facts and considerations at the time.

Q. Well, if you have an upper limit, I would appreciate it if you would state the amount.

A. I do not see how you can talk about limits at all, [fol. 6551] Mr. Littman, because I am not making a study where I am prescribing limits. I am merely saying, from the facts based upon the particular theory which I believe to be sound and which I am using, that the company must have this particular annual dollar return to maintain the service to the customers and maintain its credit position.

Q. Now, you used a moment ago the term "necessary" in describing and in characterizing this amount of $5,064,821, did you not?

A. Yes, and I further said that the total amount is, in my opinion, an irreducible minimum to render this service and maintain credit.

Q. Would you say that any amount in excess of $5,064,821 was not necessary for the purpose of satisfying the current capital requirements of Panhandle Eastern upon all of the assumptions that you have assumed for the basis of your study as it is summarized in Chart No. 37?

A. Well, to be sure that we are still talking about the same thing, if all the conditions under which you make your statement were identical with all the conditions that I studied here and made calculations upon, I say, in my opinion, that the Panhandle Eastern Pipe Line Company could maintain its service adequately to the customers and maintain its credit position if it needed additional financing and I say no more.

[fol. 6552] Q. Do you mean that Panhandle Eastern could do that with the $5,064,821?

A. If all the conditions were identical with what I considered here.

Q. And any amount in excess of that would not be necessary for that purpose?

A. I do not see that it would, although if they could get it, they would be just that much better off as the management of the company.

I mean, there would be additional amounts to surplus that, in my opinion, would just make the company that much more secure but they would not have to have it, in my opinion, to maintain the service and to maintain their credit to the public.

Q. And it would not, of course, then be necessary to have the additional—

A. (Interposing) It would not be an unsound managerial condition, if they did have it.

Q. Of course, from Panhandle Eastern's standpoint, it would be well to have more; speaking in the terms that any man in business wants to make as much as he can?

A. Well, or to state it differently, I think it is good, sound business policy for any management to, if they can, have a certain amount filtering through after all charges and expenses to surplus to build up just a good, what you

[fol. 6553] might call margin of safety for contingencies and so on, but if they do not have it year in and year out and can get this necessary income, all right, but if they did have it, it would be just so much additional margin of safety.

Q. Now, in all of this discussion, Mr. Coffman, you have not mentioned the public. We have been, thus far, looking at this amount purely from the standpoint of the investor, have we not, in our discussion?

A. Well, no. I thought I had mentioned the public in these last answers I have given you. I say that at least there are two very definitely interested parties here, the public who is in receipt of the service being rendered by this company on the one hand, and the investors on the other, who are, at present, having money invested in the firm and who, from time to time, may be asked to put in more money, so I thought I had definitely mentioned the public and certainly these figures take that into consideration for the various deductions which you referred to a little while ago are deductions necessary to maintain this service and to render adequate service to the public.

Q. Now, Mr. Coffman, we are, at the moment, presupposing adequate allowances for operations and maintenance and taxes and amortization and we are confining, for [fol. 6554] the moment, our discussion of this $5,064,821 which you have labeled a "fair return to investors".

Now, confining ourselves to just that and assuming that Panhandle Eastern were to earn more than the $5,064,821 under the conditions which you have assumed, from the public's point of view, would it not be true that the excess would represent something in excess of a fair return and something in excess of that which is necessary to Panhandle Eastern for its earned capital requirements, isn't that correct?

A. I would say that as long as conditions are identical or the relative relations of these figures remain the same, that any amount in excess of the $5,064,821 would be available, either if the management or the Commission would allow it, for adequate or additional margin of safety or, if they felt it was not necessary, it could be passed along in the form of a reduction in the charge to customers for service.

Q. Then your answer to my question is "yes"?

A. Well, I was not so sure I understood your question thoroughly, so I would like to stick by my own answer if I can.

Mr. Littman: Suppose we have the question read again and ask you to see if you cannot answer that question yes or no.

[fol. 6555] (Whereupon, the question indicated was read by the reporter.)

Mr. Littman: Perhaps I should use the term "rate payer" rather than the "public."

The Witness: Mr. Littman, I do not want to appear to be talking overmuch or dodging your question, but there is a certain phase of that question which I still do not think is perfectly clear.

By Mr. Littman:

Q. What disturbs you, maybe I can clear it up?

A. You say we presuppose adequate tax allowance and so forth which is perfectly all right except for one thing. I want to make it clear, in my theory as I have applied it throughout, that I am talking about the conditions as I have found them at the time and I am not presupposing, at the moment, that this reserve and that is sufficient because I contend that if conditions change so that the capital markets, among other things, have altered to the point where you can not finance on the same basis that we were talking about here, then I would not want to give my figure until I had taken those new conditions in to make a study so I prefer to stick to my answer, if you [done] mind, because I want to be sure that I am getting across the particular type of approach that I thought I was actually doing.

[fol. 6556] In other words, I am not saying here that $5,064,000 from here on out for Panhandle Eastern is a perfectly adequate or irreducible minimum. I am not saying anything like that whatsoever.

What I am saying is that if conditions should be identical with the conditions at the time I made this study, then I say $5,064,821 looks—

Q. (Interposing) Under those very conditions—

Mr. Wheat: (Interposing) Wait a minute. He did not finish his answer.

The Witness: (Continuing)—looks like a fair amount so that the company could maintain its service to the public and, at the same time, maintain its credit position, yes.

By Mr. Littman:

Q. Now, under those conditions which you have just assumed, if Panhandle Eastern were to earn in excess of $5,064,821, would such excess represent an excessive return from the rate payers' point of view?

A. Well, in that case, depending on how you define "excess", it is more than I think the company needed at the particular time under the particular conditions to maintain the service and its credit position and I would say then it was for the Commission to determine whether or not that excess was sufficient to warrant some reduc- [fol. 6557] tion in rates or something else.

In other words, I can conceive of the point where even though my figure, which is an irreducible minimum, is more than met that the Commission might well figure that the overage could well be accumulated in surplus as a margin of safety.

Q. Well, now, does this amount of $5,064,821 which you have called a "fair return to investors" in Chart No. 37 include surplus accruals which are adequate, in your opinion?

A. Yes. That is the total amount that is necessary prior to interest charges and the various requirements of the other forms of capital that are presently outstanding in the capital structure of the company.

Q. Does this $5,064,821 which appears in Chart No. 37 represent, in your opinion and under the conditions which you have assumed, a fair return as defined by the United States Supreme Court in the Bluefield case?

Mr. Culton: You aren't reading Mr. Justice Brandeis' definition of fair return, are you?

Mr. Littman: I am using Mr. Coffman's quotations which are shown in his exhibit.

Mr. Culton: I thought when you referred to maximum return you probably had in mind Justice Brandeis' suggestion that there is some leeway in between minimum and maximum.

[fol. 6558] Mr. Littman: I think my question is clear. If this witness does not understand it, I will try to make it clear.

The Witness: Can you give me the reference page, please. What is that page number?

Mr. Wheat: Page 3 of your statement.

By Mr. Littman:

Q. Page 3 of your Exhibit 65 contains a quotation from the Bluefield Water Works and Improvement Company versus Public Service Commission of West Virginia Case.

A. Well, Mr. Littman, my answer to that, I think, is very definitely "yes",—I mean I have just taken time to read it again and I thought it was at the time and I still do think we are following that very closely.

Q. In other words, $5,064,821 represents, in your opinion, a fair return within the meaning of that term as used in the Bluefield Case?

A. And under the conditions existing under the study.

Q. Now, we have from time to time been referring to certain conditions which you [asssumed], in arriving at the figures shown in Chart No. 37.

I should like to know what period of time is contemplated by the fair return shown in Chart No. 37.

Mr. Wheat: You mean whether those figures are stated on an annual basis?

[fol. 6559] Mr. Littman: No.

* * * * * * * *

By Mr. Littman:

Q. Do you understand the question, Mr. Coffman?

A. Yes, but there again I am going to answer the question and if you don't think I answer it directly, you can correct me.

As you know in the calculations that I made, there were certain estimates made in regard to taxes, an assumption of a change in capital structure in regard to the preferred stock and so forth.

I think there were only three, as a matter of fact, an estimated increase in the raw materials and wages, an [fol. 6560] increase in taxes and the change in the preferred stock, as I recall it. If I am wrong, the study will show.

Q. Chart No. 37, if I may refresh your recollection, does not contemplate a change in capital structure.

A. Then the estimate I made for the change in raw material prices and wages and the change in the taxes which supplement statement—

Q. (Interposing) And the change in the amortization allowance.

A. Yes, correct. Those items made, as I have mentioned, the only changes from the 1941 actual statements as will be shown in my report so that I am not contemplating any period of time for the $5,064,821 for the reason that I have given before.

I still come back to this matter, assuming the conditions which I took into consideration in this study and I am not saying that from here on out for four years or five years or for any other period, that this figure would be the figure at all.

I am saying that so long as these conditions maintain what they are, this is the best judgment that I have in regard to the question and certainly, under present conditions as they are existing, I would ~~not be~~ talking in terms of two, three, four or five years.

I do not think any other analysis would [—] just on the [fol. 6561] basis of what external conditions are doing to all of us. I mean who knows what is going to happen next month or next year or two years hence?

Q. Mr. Coffman, would you say that this figure and these figures shown in Chart No. 37 would hold good for at least a year after June 30, 1941?

A. Well, at the time I would make any such study, I would make it up hoping that the condition would last as

long as the company but the very purpose of my particular theory, if it has any soundness to it at all, is to give some method whereby currently, from time to time, you can make a check on these matters as against the old method, where, as I saw it, it was a rather laborious task to figure a rate base which took months and months of engineering work and then a rate on the other hand and thereby get some combination which would stay for quite a period.

I am trying to develop a theory, if I can, by which it would be very simple to check conditions from time to time to see what actually would be fair at the particular time and I thought I had really got on to that in this study and the approach that I made.

Q. Well, coming back to my specific question with respect to a one-year period, you would not say that these figures would hold good for even one year in the future, would you?

[fol. 6562] A. I would start out with these figures hoping they would hold good for quite a while but, being well aware of the fact if conditions changed materially, it would be very simple to make this study all over again in view of the changes and see what the situation was.

Q. Six months or more have elapsed since June 30, 1941, which was the end period of your actual figures. Would you say that these figures hold good for the six months that have elapsed?

We are looking back in retrospect.

A. I think they are holding fairly well and yet, among other things, there are two material changes that have taken place, not referring to this company particularly but taking companies, generally, most of them have shown further increases in earnings.

That is particularly true of industrial companies as the quarterly statements have come out since June have shown higher earnings.

On the other hand, taking the capital markets as we know and particularly after the Pearl Harbor situation, prices of securities have gone down so here we have two fundamental factors that are most important in any such consideration as this, higher earnings and lower prices.

Ordinarily, that would not make sense to any individual but the fact is, it is a fact. You can read the statements [fol. 6563] every day and see that there is no question about it.

Q. Is your answer to my question "yes"?

A. I say that, generally speaking, I think the figure has held but if I were to make this study right today, it might be a few dollars different.

Q. You would not expect it to be much different if you did make a new study today?

A. I do not think, dollar-wise, it would be a great deal of difference, but some difference.

Q. Perhaps, if I stated to you, Mr. Coffman, the reason for my inquiry in this connection you might be in a better position to answer my question.

I would like to know to what practical use these dollar figures may be put by this Commission? I fear that unless the Commission knows the period of time for which these figures may be used in the future, that these figures may be of little practical value to the Commission.

I, therefore, want you to fully explain your position with respect to the time element inherent and implicit in the figures shown in Chart No. 37.

A. Exactly. Well, I think that does help me quite a bit.

If you will give me just a few minutes to tell you why I used this particular type of approach, I think probably we would both be getting together.

[fol. 6564] Over a good many years in my position in making studies on public utilities, of one kind or another, we have made specialized studies, investors' appraisal of risks and so on, in various phases of rate of return cases.

During the course of that experience, I have had occasion many times to look over reports of others, general approaches that were used, and I have read a good many cases on the subject.

It impressed me as I read these various reports and the cases that the methods that had been commonly used to that date included an elaborate study and investigation, on the one hand, usually from an engineering point of view to determine a rate base.

This, at least, supplies figures to the Commission which would give you something on that angle of the problem. Then, on the other hand, a report of another group, usually economists or people qualified to make the study to make their best determination of a rate, as such.

It seemed to me to leave certain gaps open that well could be fortified and I have been for several years undertaking to discover something that might fit in the middle of all this so if a person said in their opinion the rate is 6, 7 or 8 percent and somebody said the rate base was [fol. 6565] $100,000,000,000 or whatever it was, the multiplication of those two figures, as I understand it, was to give you a fair rate of return, dollar amount.

A good many times, as we know, it did, and a good many times, as we know, it did not.

What I have tried to do is to slip in between those two things, if I can express it that way, and get a method from an economic point of view which would assist in arriving at a dollar figure which, in any one's best judgment, would have to be had to maintain the service adequately to the public and maintain the company's credit position, and I think the purpose of this figure is to do that very thing, so that if, for example, under the old method, as I term it, a multiplication of a rate, so determined by a rate base, let us say as it worked out gave us $6,500,000 under these conditions and I make my study just as I have done and come out with $5,064,000, I say the Commission, in this figure, has a very good one to check the result of those other studies and that was the whole purpose of this particular approach as I used it.

Now, this figure, I say, will hold up to a reasonable extent the same as a determined rate of 6; 6½ or 7 times $100,000,000,000. will stand up and no longer because the reason your other rate changed was because conditions changed and the only reason this will change is because [fol. 6566] conditions changed so that is my explanation of this particular approach.

Q. Is your approach a substitute or a check of the old or, may I say, the classical method heretofore used in rate making?

A. Though appearing egotistical, if I can make the statement, I think this comes a little closer to fitting actual conditions in the world we are living in today than the old, classical approach does.

I won't say it is a substitute but I think it ought to be a part of the over-all consideration, I mean throw this in the hopper with the rest and it may be a very good double check.

Q. Coming back to the time element, I take it from your answers that you are unable to state at this time how far in the future this figure of $5,064,821 which you have called a "fair return to investors" may be projected?

A. Well, avoiding answering your question in terms of months or years, I think this figure will hold up as long as a figure you determine from your old classical approach will hold up and no longer, because the only reason that I know that the results of the old classical theory went bad was because conditions went bad.

The same thing is true of this and no more. I do not see why this figure would not hold up as long as your other [fol. 6567] figure holds up.

Q. Then you cannot state, in days or months or years, can you?

A. No, I say as long as conditions remain relatively as they were here, this figure holds.

Q. How long do you think we may expect conditions to remain as they are, inasmuch as we must make a reasonable [forecase] in the future?

A. Well, of course, on all operations of any kind for any industry for any company, you have got to go ahead operating, assuming that you will be able to meet conditions.

At the present time, I do not see how anyone can figure that they can see much more than six months or a year ahead because the defense program is going to lead us to points that probably none of us suspect and make all kinds of changes and even though that is true, it does not negate, it seems to me, this study at all.

It is just one of those things under which a man has to operate. It makes the operations a little more difficult

and the figuring a little more difficult but we have to go on living just the same.

Q. Well, if we are going to put this study of yours to any practical use, Mr. Coffman, I assume from what you have said that we must make a new study similar to that [fol. 6568] which you have made throughout to get a new answer before acting on the matter in the question of rates in this proceeding, is that correct?

A. No, that is not correct, Mr. Littman, because I just got through saying this figure will hold up as long as a figure you get from your classical procedure will hold up.

If you say I should make another study in six months following my procedure, then I say you should make a study in six months following the classical procedure.

Q. Then this approach is no different from the classical method—

A. (Interposing) So far as the time element and being useful is concerned, not at all.

Q. Now, if I correctly understand this new theory of yours and it is a new theory, isn't it, Mr. Coffman?

A. I do not believe it is a new theory, Mr. Littman. Actually, I think I have been following the Bluefield Case and United Railway versus West and the Solar Electric Case and so on. If there is anything new about it, I think it is merely trying to reduce the thing to tangible form instead of just talking, and I tried to put the thing down so a person could see it in figures and charts.

Q. Then this study of yours is not new?

A. In its present presentation, I have never seen it [fol. 6569] set up in this form but, so far as the actual theory is concerned, I think I have just made a literal interpretation of those law cases I mentioned.

Q. Well, this approach is different from any heretofore used by any other witness, to your knowledge, in a rate proceeding, is it not?

A. From the standpoint of making it all in one collective parcel, I think perhaps that is true. From the standpoint of using a continuous graphic and statistical story is concerned, I think it is true, but so far as the various elements that have been taken into consideration, to the best of my ability, they are just the same elements, as I remember the Bluefield Water Case.

I do not think I took in any more or left out any.

Q. I was not talking about the elements that you claim you considered and which elements others have considered. I am talking about the approach, the method used to arrive at the results.

A. And the form of presentation?

Q. That is right.

A. Yes. I have never seen anything like this before, no.

Q. It is your own idea? A. That is right.

Q. And as you have heretofore testified, you do not [fol. 6570] arrive at a rate of return?

A. No, sir, I arrive at the dollars needed, as I say, to maintain the service to the public and the credit position.

Q. And those dollars remain the same regardless of the rate base that may be adopted by the Commission?

A. Yes, I think so, because you have here a property, a management operating the property. It takes so much for wages, materials, operating expenses and so on.

You must have enough dollars, then, to cover all of those items so that the service will be good to the public and also so you will have something left over for capital to meet the necessary capital requirements.

Q. And do I correctly understand that, in your opinion, Panhandle Eastern Pipe Line Company and its wholly owned subsidiary, Illinois Natural Gas Company, must have, as an irreducible minimum, annual gross revenue of $15,459,545, assuming that the present preferred stock is refinanced, or $15,520,855, assuming no change in the present capital structure, such sums to be available to meet operating expenses, taxes, current capital requirements and provide a reserve to restore invested capital after the gas reserves of the company are exhausted?

A. Yes, sir, so long as conditions remain relatively as they were at the time I made the study.

[fol. 6571] Q. And your ultimate conclusions in this regard are summarized in graphic form in Charts 36 and 37 of Exhibit 65, is that correct?

A. Yes, sir, that is correct.

Q. Now, in arriving at your conclusions as to the so-called "irreducible minimum of annual gross revenue", you made no examination of the books and records of the company, did you?

A. No, sir. In this particular case, I used the published annual reports of the company which were in our files.

Q. And you made no examination of the property itself? A. No, sir.

Q. You are not an engineer? A. No, sir.

Q. You are not a geologist? A. No, sir.

Q. You obtained your information, as you just stated, from the annual reports of Panhandle Eastern Pipe Line Company and the other companies with which it was compared and other public sources, such as records from the Bureau of Mines, Standard Corporation Records, and Financial and Commercial Chronicle, is that correct?

A. That is correct, yes, sir.

[fol. 6572] Q. Now, you undertook no investigation of the original cost or the value of the property itself?

A. No, sir.

Q. Nor have you related your estimate of dollars of gross revenue required to any value of the property claimed for rate making purposes, have you? A. No, sir.

Q. Now, Mr. Coffman, if this new method which you suggest is correct and proper, if the amount of gross revenue can be correctly and accurately determined by your method, then it would not be necessary to determine any rate base at all, would it?

A. It may very definitely be necessary from the standpoint of wanting to keep track of the figure and see what is going on so far as the invested capital of the company is concerned, but the figure that I have gotten is merely one which can be related to these other figures as a matter of checking other approaches.

I am not content to say "use this and none other", but I am perfectly willing to say this should be used along with others to keep the thinking straight.

Q. But you arrived at your "dollars needed annually by Panhandle Eastern to provide service to customers, a fair return to investors and restore invested capital when gas reserves are exhausted", without having first determined a rate base, is that correct?

[fol. 6573] A. Yes, but that does not mean that it was ignored altogether, Mr. Littman, as you know, because in the figures in operating expense you do have maintenance

figures, you have depletion and depreciation figures and so on which, after all, are related to the investment.

As we all know, gas reserves at one time for a company for example, can be estimated to last 75 years. When a person takes a new look, it may be 25 years.

In this particular case, we took what seemed to be a reasonable average of 25 years based upon fact that were available but we did not determine that upon an engineering or geological study.

Q. You do say you ~~had~~ a rate base in mind all the while?

A. I say in this case since I took the figures on depreciation and [delpletion], except for the change that I have mentioned in regard to the gas reserves, putting them on a 25-year basis, those figures are related to the rate base.

I did not have to relate it because I did not audit the books nor make a depreciation study. I assumed that the figures published in the annual reports which are certified by reputable public accountants was somewhere within the realm of reason and I took those figures but, at [fol. 6574] the same time, depreciation is tied in with the tangible property, as you know.

Q. But you did not use a rate base in making your determination of the fair return, did you?

A. No, except that, as I say, in these deductions that you were referring to a little while ago, there are certain figures which are related to a base and those, of course, are used in the calculations for income here.

Q. And what is that base to which you have just referred?

A. In this particular case, they were the book figures as shown in the published annual reports.

Q. The investment—

A. (Interposing) As shown in the annual reports.

Q. In other words, you relied exclusively upon the investment in the property as reflected by the company's books, is that right?

A. No, I did not rely heavily but, in so far as a figure for depreciation or maintenance is concerned, those figures were taken from the annual reports of the company and

the reason that that source was used rather than company figures was that, so far as the investing public is concerned, they have only the annual published reports of the company from which to get information.

They cannot go to the company books so I wanted to [fol 6575] place myself in exactly the same position they were in.

Q. You were interested primarily in the investment in the property as reflected by the property accounts of the company?

A. I would not say that I was interested primarily in that because the whole business is wrapped up in one package. I do not see how you can separate it. When you talk about operating expenses, I do not see how you can separate them when there is service to the public.

When there are expenses, then you obviously are considering the public and, after all, of the total amount of the $15,000,000 I am talking about, three-quarters of it is wrapped up in service to the public.

There is only one-third of it that is wrapped up with the investing public, as a matter of fact, less than one-third, so I do not see how you say I lean heavily on the investing public and pay no attention to the consuming public.

Q. Am I correct in understanding that under the method that you used, you can arrive at the total dollars needed and so forth as used by you—

A. (Interposing) May I have that question read?

Q. I have not finished the question. Suppose I start over again and I will read the whole title.

Am I correct in understanding that under your method, it is possible to arrive at the "dollars needed annually by

[fol. 6576] Panhandle Eastern to provide service to customers, a fair return to investors and restore invested capital when gas reserves are exhausted", without having first determined a rate base for rate-making purposes?

A. I think that is very definitely possible, yes.

Q. It is true under your method, is it not?

A. That is right.

Q. And if your method is correct and proper, you can determine the amounts of deductions from revenue, to wit,

the operation and maintenance expenses, the taxes and the return of capital when gas reserves are exhausted without an examination of the company's books?

A. I think so very definitely because I just cannot conceive that any company in this country today, whose books are certified by a reputable firm of public accountants, has anything in its published annual reports that is at variance or at substantial variance with the facts and, so far as the individual deductions are concerned, much of it is for various items that are in the nature of wages, payments for materials and so on and for which you definitely know, from the amounts paid out, what the sums are.

I do not see why you have to audit the books. They have already got a firm of accountants out there doing it and they have certified their statements. I do not know what good it would do for me to go all over that.

[fol. 6577] Q. You do not see any point to an examination of the books by the Commission for the purpose of ascertaining the propriety of the claimed expenses for operation?

A. Well, that is a different question, Mr. Littman. If the Commission has any question about the propriety of any items or the way any accounts were conducted, of course it would be the only thing to do, to examine the books.

In my particular case, obviously, that was not my assignment and I took the published annual reports which were certified by reputable public accountants as being reasonably close to facts but, if the Commission has any question about any of the figures, the only way I know to get it is to go to the company and get into the books.

Q. Mr. Coffman, you have a whole rate case, this entire rate case, within the confines of the first and last pages of your Exhibit 65, have you not? A. That is correct.

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[fol. 6578] Q. Mr. Coffman, I take it from your previous answers that you consider the method which you used to arrive at the dollars needed annually by Panhandle Eastern to provide service to customers, a fair return to invest-

ors and restores invested capital when gas reserves are exhausted was a fair, proper, equitable and correct method?

A. Yes. I go further than that, Mr. Littman, and say that it is really an [indispensible] part of such a study.

From an economic point of view I feel that a rate study without this is considerably inadequate.

Q. And you think that the use of the methods which you have employed which are set forth in Exhibit 65 can give the correct answer to the question of how many dollars are needed annually by Panhandle Eastern to provide service to customers, a fair return to investors and restore invested capital when gas reserves are exhausted?

A. Yes and, further, I say that without such study any other result that you get is still faulty for a lack of such considerations as I have made.

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[fol. 6579] A. I said that I had used, so far as the company was concerned and so far as companies with which this company were compared, most of those figures coming from annual reports come from certified statements.

Q. Well, now, will you refer us to the statement which you used for the company's figures for the year ended June 30, 1941?

A. On the table for Chart No. 13—that is at the end there, there is no page number on that—is presented a table captioned, "Panhandle Eastern Pipe Line Company, Consolidated Statement of Profit and Loss for the 12 Months Ended June 30, 1941", and the footnote there is from the company's report of June 30, 1941.

Q. Was that an audited report?

A. That particular statement may not have been audited because it was not an annual report, but my statement to you was that the figures came from annual reports.

If I used an interim figure, there is no annual report for that. I am not inconsistent in what I say.

Q. I wanted to be clear on the subject. A. Yes.

Q. You were not endeavoring to say that you used audited reports throughout but that wherever the interim figures were used those were not audited figures?

A. Those would not be the published annual reports, [fol. 6580] but I would like to enlarge my answer to point

out that I have considered, as you know, a number of years, full years, in comparisons here and those were from the annual reports in most cases and the interim statements are comparatively few in number.

Trial Examiner: May I suggest that you make careful reference to your exhibit numbers in your references? The last one I assume was to Exhibit 65.

The Witness: The last one was to Exhibit 65, yes.

By Mr. Littman:

Q. Well, now, Mr. Coffman, if your method is correct and fair and is the proper way of determining the required amount of gross revenue for rate making purposes, then we are simply wasting our time in this hearing going through the process of determining a rate base and determining the sums to be allowed as operating revenue deductions, are we not?

A. Well, of course, if I answer you "yes", Mr. Littman, it is a pretty strong statement and one that is so strong as that, it seems to me, should have some explanation.

I say this: That so far as I know the cases to date, anyway, have been predicated upon the old classical approach and if there have been inconsistencies or erroneous results gained therefrom, which there have, it seem to me, which accounts for the various cases now before the Com- [fol. 6581] mission, I should say that at this point perhaps it would be helpful to look at this kind of an approach.

I do not see how one can determine the final result without doing it. For example, to turn the answer around, if you will tell me whatever rate base the Commission has determined to set, I have no trouble, as you know, from my figures in determining what the rate should be.

In other words, if my figure is the best judgment that can be made on this particular thing of $5,064,824, if I know the base, it is a simple arithmetical calculation to find out whether that is 6, 7, or 8 or some fraction in between or lower.

Q. But, Mr. Coffman, assuming that your method is 100 percent correct and proper and fair, then there would be no need for the Commission to do anything but to accept your estimate of minimum gross revenue required for

Panhandle Eastern Pipe Line Company and adjourn these hearings without the necessity of determining a rate base and investigating the propriety of the various expenses claimed. Is that correct?

A. No, that is only partially correct. Let us put it this way: If the Commission had satisfied itself, to use your language, as to the propriety of the individual accounts in the company's books and after such investigation had [fol. 6582] found that those figures were proper throughout, then my answer is "yes, I think this is the answer" and it would continue to be the answer except if in your investigation you found this account or that account improper as to some of its contents.

Otherwise, I say this is the figure.

Q. In other words, your study is subject to check with respect to the accuracy as to the amounts of deductions from revenue which are assumed by you in your exhibit?

A. Well, let's use this phrase, it is so in so far as the deduction is applied to the Property Account.

In other words, if the Commission would study the Property Account and find that the figures upon the books or later contained in the annual report were definitely about as accurate as you could get and the calculation for depreciation based thereon was right, then my figure stands.

Q. Then, original cost or prudent investment would be accurate from your point of view, would it not?

A. Well, I would say that both factors have to be considered very definitely. The original cost, presumably, has been accumulated on the books. Also, for a period of time of the company's operations there have been additions to surplus which are, also, a part of the accumulation of earned surplus.

The prudent investment theory, so far as I see, I con- [fol. 6583] sider when I talk about the capital markets, because there I am trying to ascertain what people reasonably, under the facts, feel they could pay for a particular security that was issued, which is, after all, representing the capital behind all these assets. I think they both have to be considered.

Q. Well, are you sponsoring the prudent investment theory by this method?

A. I am sponsoring my theory and nothing else, Mr. Littman. That is about the way I would like to put it. I did not make an original cost study but I did make this study and so far I am willing to defend it.

Q. If the company's accounts, as shown on the books, property accounts reflect no water, then those accounts would reflect the original cost, would they not?

A. No, there is a qualification on that statement from an accounting point of view. There are certain items, as you know, in the construction of any property or plant wherein there may be a question at a given time as to whether you will capitalize the item or whether you will charge it to operating expense, and there may be some place along in any company where certain items were capitalized and certain were not.

If a policy had been followed throughout which in its inception was believed to be sound and henceforth had been [fol. 6584] followed consistently, I would say yes, but if there had been places along the line where at one time certain things had been capitalized and other times where they had been charged to expense, I would say it might be worth an investigation to see.

Q. With those exceptions which you have named and which are, for the most part, minor, your answer to my question would be yes? A. Yes, that is correct.

Q. Well, are we together on this: That under this method that you have presented in Exhibit 65 you determine the amounts of dollars needed annually without the use of a rate base?

A. Well, I do not think that is a fair way to put a question for this reason: A rate base, after all, is the sum total of dollars that go into the property and upon that certain [deductible] items such as depreciation, depletion and maintenance relate to that base and yet those items are not balance sheet items but they are operating statement items.

To the extent that those items are included as deductions, it seems to me that you cannot say "with no relation to a base"; you have to qualify it, at least to say to those de-

ductions that were made upon the Property Account, property, as I use it here, taken from the statements.

[fol. 6585] Q. With those exceptions that you have named, there is no rate base utilized?

A. That is right and, as I say, other than those exceptions I do not need one. If you will tell me what the base is, I will tell you the rate.

Q. And to the extent that you have utilized a rate base, as you have just described it, you have utilized the investment in the property?

A. The investment in the property as recorded in the annual reports of the company.

Q. Yes. Is that right? A. Yes.

Q. In your opinion do those reports reflect something very close to actual legitimate investment in the property?

A. Well, so far as I know they do, Mr. Littman, but as I say my answer is not predicated upon an audit or engineering investigation. I have made the assumption that, the reports having been audited, the figures were reliable and I have so accepted them.

Q. In order that there be no misunderstanding on this score, Mr. Coffman, am I correct in understanding that we are agreed that if in these preceedings it should be established that any of the figures upon which you relied for "operations and maintenance", "taxes" and provision for [fol. 6586] amortization are shown to be less than the amounts which you show in Chart No. 37, then the amounts would have to be reduced accordingly, would they not?

A. Yes, if by an investigation that you make you find any variation, of course, it will make a change.

Q. And that would, of course, reduce your "Total Dollars Needed" accordingly?

A. If you change one variable, you change them all.

Q. So your answer to my question is "yes"?

A. That is right.

Q. A moment ago I used the term "amortization". I was referring to the figure of $2,541,034 shown in Chart 37 of Exhibit 65 which is labeled "Return of Capital When Gas Reserves are Exhausted".

Did you so understand me?

A. Yes, I did.

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[fol. 6587] By Mr. Littman:

Q. Now, you show on this chart that $2,541,034 is required annually to return the invested capital to the investors when the gas reserves are exhausted. Is that correct?

A. That is correct.

Q. What is the amount that was charged for this purpose by the company in the year ended June 30, 1941?

A. The amount was $2,316,560, as shown on Chart No. 31 of Exhibit 65.

Q. In other words, your provision for amortization is $224,474 more per year than the amount which Panhandle Eastern Pipe Line Company charged on its books for depreciation and amortization for the year ended June 30, 1941. Is that correct?

The Witness: Will you read that statement, please?

(Whereupon, the pending question was read by the reporter.)

The Witness: The figure should be $234,474. I think you said, $224,000. It is $234,474.

By Mr. Littman:

Q. Mr. Coffman, if you will look at Chart 37, you will note that your figure is for "Return of Capital when Gas Reserves are Exhausted", $2,541,034.

A. That may be a typographical error. Let me look at the table supporting that figure.

[fol. 6588] Your figure is correct. That is $224,474 and the figure on Chart No. 31 is a typographical error and should be stated as $2,541,034.

Mr. Wheat: Mr. Examiner, may that correction be made, that typographical error?

The Witness: It is the supporting figure, Mr. Examiner, on Chart No. 31, that is a typographical error of $10,000.

Trial Examiner: The correction may be made in the copies of this Exhibit 65.

By Mr. Littman:

Q. Am I clear in understanding that your provision for depreciation, depletion and amortization is $224,474 more

per year than that which Panhandle Eastern charged for those purposes for the year ended June 30, 1941?

A. Yes, that is correct.

Q. Now, will you please state how you arrived at this figure of $2,541,034 for depreciation, depletion and amortization?

A. That figure is explained in the statement opposite Chart No. 31 in Exhibit 65 wherein I state in the second paragraph:

> I made no actual survey of the properties nor did I question the adequacy or inadequacy of the annual provision for depreciation, depletion and amortization, however, in order to determine the dollar amount that would be necessary to return capital to investors when the company's [fol. 6589] reserves are exhausted I adopted the assumption that the company's reserves would last for an additional 25 years as indicated by Ralph E. Davis in Registration Statement No. 2-4579, filed November 18, 1940, and computed by a straight line method an annual provision necessary to return $63,775,839 of invested capital over such period.

Mr. Wheat: Pardon me, Mr. Littman. I believe that the witness ought to recalculate that amount.

We have been trying to calculate it and I do not believe that there is that error that he just mentioned. I think we ought to be sure as we go along. I think this is a mere matter of arithmetic.

By Mr. Littman:

Q. Mr. Coffman, perhaps this would be helpful, suppose I tell you my understanding of the figures and then you tell me whether I am correct or not. A. Yes.

Q. In arriving at the figure of $2,551,034 shown in your Chart No. 31 you used as the invested capital the sum of $63,775,839. A. Yes.

Q. And obtained the amount of dollars for amortization by dividing 25 years into the sum of $63,775,839. Is that right? A. That is right.

[fol. 6590] Q. Now, is it correct to say that your $63,775,839 represents the invested capital based upon your proposed changed capital structure?

Mr. Wheat: May I suggest, Mr. Littman, that the witness look at Chart No. 36 as well as Chart No. 37 in connection with Chart No. 31 and, I think, if he then will divide his figures, he will find that the correction heretofore made should not have been made in Chart No. 31.

The Witness: Yes, that is correct. On Chart No. 36 the assumption is made that there is a refinancing of the preferred stock.

By Mr. Littman:

Q. Yes.

A. And on that figure the item captioned "Return of Capital When Gas Reserves are Exhausted" is $2,551,034.

Q. Now, am I also correct—

Mr. Wheat: (Interposing) Pardon me, I think the witness still had a part of his explanation to finish and there is another figure on the text in reference to Chart No. 31 that he ought to explain at the same time.

The Witness: To continue, the figure on Chart No. 37 of Exhibit 65 is calculated on the basis of the present capital structure without refinancing the preferred stock, so that the item "Return of Capital When Gas Reserves are Exhausted" is correctly stated in the amount of $2,541,034, [fol. 6591] so that the statement that you make about the overage of one figure against the other would apply if you were talking about Chart No. 36 and my figure, as I originally gave it, would apply if you are talking about Chart No. 37.

Mr. Wheat: In that connection, I wonder, Mr. Coffman, whether you hadn't better check the figure in the text with reference to Chart No. 31 so that we will be sure that we have the correct figure.

The Witness: Yes, sir.

Well, there the figure is stated in the last full paragraph in the fourth line from the bottom, that the estimate of $2,511,034 as the annual amount necessary to restore to investors when the reserves are exhausted should be $2,551,034 as shown in the specific Chart No. 31.

Mr. Wheat: May that correction be made, Mr. Examiner?

Trial Examiner: Those corrections should be made in the exhibit.

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By Mr. Littman:

Q. Well now, am I correct in understanding that you arrived at your sum of $2,541,034 shown in Chart 37 and called there "Return of Capital When Gas Reserves are Exhausted" simply by the dividing 25 years into the sum of $63,525,839 of invested capital?

[fol. 6592] A. Yes, sir.

Q. Now, will you please turn to Chart 26 and state whether that chart shows the invested capital figure of $63,525,839 which you used for purposes of arriving at the amount of amortization? A. Yes, that is the figure.

Q. Now, this $63,525,839 figure which you used for your amortization basis is simply the total of all of the outstanding bonds, preferred stock, common stock and surplus, is it not, as of June 30, 1941?

A. Yes, what we have termed the "Invested Capital" as of June 30, 1941.

Q. Well, what amount of earned surplus is included in that $63,000,000-odd figure?

A. Well, I cannot give you the breakdown figure. I have the table which supports Chart No. 26 shown at the end of the Exhibit No. 65, but there the figure is grouped.

Mr. Wheat: I have here the report from which the witness obtained that group figure from which he can obtain the breakdown which is not shown on this chart, if you would like to have him do that.

Mr. Littman: It is perfectly satisfactory for the witness to make reference to any working papers to refresh his recollection.

(A document was handed the witness.)

[fol. 6593] Mr. Culton: The source of it, Mr. Littman, is shown at the bottom of the table, Chart No. 26, from which he made his computation.

Mr. Littman: I am quite certain that the same figure can be obtained from Exhibit 48, Page 2.

Mr. Wheat: I feel sure that is correct.

Do you have that figure now, Mr. Coffman?

The Witness: Yes, I have it.

Mr. Wheat: What is it?

The Witness: $9,074,122, which is calculated by taking from the condensed consolidated balance sheet as of June 30, 1941, unaudited, of the Panhandle Eastern Pipe Line Company and its subsidiary company's common stock in the amount of 807,367 shares issued and shown on that balance sheet as $20,184,175, subtracting the latter amount of dollars from the total figure, $29,258,295, which shows the $9,074,122.

In other words, I have eliminated the common stock figure at its book figure.

By Mr. Littman:

Q. The surplus shown on Page 2 of Exhibit 48 in Line 42 as of June 30, 1941, is $9,074,120,08.

A. That is correct. I said $122, it is $120, that is correct.

Q. Now, in your opinion, can the amount of depreciation, depletion and amortization be accurately and correctly determined simply by dividing the total invested capital by a given number of years?

[fol. 6594]

A. Well, so far as I know, Mr. Littman, that is the way it has always been determined. So far as your statement is concerned, it is dividing one figure by another.

Now, as to whether you divide by 25 or 30 or some other figure, that depends upon the most competent person's judgment who does the job to tell you what the years are.

In this particular case I have assumed that Mr. Ralph E. Davis was one of the leading engineers in the country on this particular situation and I would accept his judgment as being about as good as any I knew.

I mean, after all, it is not just as if you have picked a figure out of the air. There was a thorough survey made and probably as important a statement as you can find, namely, a Registration Statement, and if that was his best judgment of a thorough and adequate study, I do not know any other figure to use for division.

Q. Well, is it your opinion that the proper way for determining the amounts to be allowed for depreciation, amortization and depletion is by dividing the total invested capital represented by the total of the outstanding securities and surplus by a given number of years?

A. Well, of course, talking about invested capital on [fol. 6595] that basis is about the same as talking in terms of a fixed property and equipment, and on that basis I do not see why, if the basic figure is accurate to begin with, the calculation would not be as reasonable an approximation or as accurate an approximation as one can make.

Q. But so far as you are concerned, the proper method is to divide the invested capital, as you have done in your Exhibit 65, by a given number of years.

A. That is one acceptable way. If you are questioning me now on various methods, there are other methods, but the straight line method is one acceptable way that has been used over the years.

Q. You consider the method which you have used as the most accurate one?

A. I think to date that it is as accurate as any other method that has been devised.

I, further, will go on and say that where the method has been used on that base it hasn't changed to some other in the course of the company's history.

Q. Do you think your method is the straight line method?

A. Well, ordinarily, I believe the phrase "straight line method" is applied where you will divide a base figure by a number of years and come out with the same exact amount per annum for the estimated length of life, yes.

[fol. 6596] Q. And the method that you have used is what you would call a straight line method?

A. Defining it as I do where, in terms of depreciation and so on, a straight line method is a procedure wherein you take the same amount at each year, that is it.

Q. Now, I believe you stated that you used 25 years in making this calculation because of a statement that had been made by Mr. Ralph E. Davis in connection with Registration Statement No. 2-4579 filed November 18, 1940, with the Securities and Exchange Commission. Is that right?

A. Yes, sir.

Q. Now, I believe the statement of Mr. Davis, upon which you relied, also appears in your Exhibit 65 in one of the early unnumbered pages of your exhibit which contains some text under the heading of "Synopsis of History and Development of Company" and under a subheading called "Property—Gas Reserves".

I believe it is the second unnumbered sheet of that text. Do you find the statement?

A. Yes, I have it.

Q. And the statement as shown there reads as follows:

"The combined gas supply controlled by your company in the Amarillo and Hugoton fields is, in our judgment, adequate to supply its present markets and any reasonably anticipated increase in the gas requirements of said markets for a period of more than 25 years."

[fol. 6597] Is that correct?

A. That is correct.

Q. Why did you use 25 years rather than a period of more than 25 years?

A. Well, because of the fact that you had to have a specific number of years in order to get an annual charge.

Since Mr. Davis had made that statement in terms of those years, I took that figure as being the one which apparently he felt could be a possible determination of exhaustion of reserves and since he mentioned no other figure I had no other figure to use.

Q. Certainly he indicated that the period was going to extend beyond 25 years, did he not?

A. Well, it may, I do not know whether it will extend one or five or what and because of the fact that he, himself, said 25, I stuck with his figure on the theory that he knew pretty much what he was talking about.

Q. Well, so far as you know, it may extend another 25 years, is that correct?

A. Well, it might but I have an idea that if he thought it would he would have said 50 years or more.

Q. Well, the purpose for which Mr. Davis' statement was presented would have something to do with that, would it not?

[fol. 6598] A. I do not quite know what you know. If he has made an engineering and geological survey, ascertaining to the best of his knowledge and belief what is the capacity of the reserves and their length of life, I presume it would not make much difference as to the nature of the study.

If he made the same kind of study, regardless of purpose he would get the same kind of answer if conditions had not changed.

Q. You made no further investigation of the matter of gas reserves other than to take the minimum period set forth in the Davis statement, is that correct?

A. We made no other study than exactly what is shown here, that is correct, and accepted the 25-year period as the basis of calculation.

Q. Are you aware of the fact that Mr. Davis has on occasion testified before the Securities and Exchange Commission that the life of these fields might extend as long as 50 years?

A. I do not believe that I have seen any such statements, no.

Q. Have you heard of any such statements? A. No.

Q. Would it make any difference to you if he had so testified?

[fol. 6599] A. Well, if to the best of his knowledge and belief he can give some specific years other than what I have here used, I would use that figure.

Q. You would revise your estimate?

A. Yes, if I had any better figures.

Q. You, of course, are not vouching for the accuracy of this 25-year estimate? I really should not call it a 25-year estimate. You are not vouching for the accuracy of the 25-year figure, are you?

A. I am using that figure and citing the source of it as the only figure that I had for the particular purpose since I had not made a detailed study myself, as I am not competent to make such survey.

Q. Mr. Coffman, isn't it true that, as has been the experience of the oil industry, estimates of natural gas reserves have increased as gas production has expanded?

A. Well, yes, the estimates have been increased. There have been new fields from time to time discovered and

there have been new methods of drilling, deep-well drilling and so forth which have in some cases given a larger supply, but, on the other hand, it is equally true that in places like Pennsylvania some years ago when they had gas there they were making unusually large estimates and suddenly the wells went dry and many investors lost large sums of money, so that it is one of those things, I believe, where [fol. 6600] you cannot reduce to a fixity at all because it is not known.

Q. Well, is the statement a correct one which I just made, to wit, that, as has been the experience of the oil industry, estimates of natural gas reserves have increased as natural gas production has expanded?

A. Yes, I think that is very true, but I would want to qualify, again, the statement, that even though there are those estimates we, also, know that reserves will exhaust.

Q. Mr. Coffman, is it correct to say that the question of over-all reserves need be given little weight for most companies in appraising the value of their securities?

A. Well, my feeling on that, Mr. Littman, is this:

The reserves of any natural resource have to be given weight, but in the last analysis those reserves are worth no more than the product can be converted to a tangible product and sold at a price on the market.

What that price will be remains to be seen. For instance, I know as an investment analyst that for many years oil companies have not been the most profitable companies and yet they have had hundreds of millions of barrels of crude oil in the ground.

The reason for that is that when they converted the crude oil to refined oil and gasoline and tried to sell it to [fol. 6601] the customer in the market, they wound up with prices that caused losses instead of profits.

The same thing goes for natural gas, so that the reserves in terms of M.c.f. is one thing, reserves of gas in terms of M.c.f. times a price is something else again.

Q. Well then, is the statement correct that I made a moment ago, that the question of over-all reserves need be given little weight for most companies in appraising the value of their securities?

A. It has to be considered very definitely and we do consider it, but in the last analysis in an appraisal of securities, it comes down in the investor's mind to whether or not the company earns or loses money. You cannot find many investors that are willing to invest in securities, even though a company has large reserves, if they cannot be convinced that such reserves can be pulled out of the ground and sold to the using or consuming public at a profit.

Q. Well, you still have not answered my question, whether the statement that I made is correct. Is it or is it not correct?

A. Well, the statement, to answer you directly, is what I have just given you, what we consider, but you say, "more or less" and I refuse to answer the question because I do not think it can be done that way without the explanation I have given you.

[fol. 6602] Q. If I would ask you the question this way, to answer true or false to this question, namely, the question of over-all reserves need be given little weight for most companies in appraising the value of their securities, would you say it is true or false?

A. Well, I would say that it was false if you wanted it on that basis.

Q. Isn't it a fact, Mr. Coffman, that Standard and Poor's, of which you are a Director and officer, has predicted a conservatively estimated life of at least an additional 40 years for the gas reserves of this country?

A. Well, I do not know the specific document to which you refer, but we have from time to time passed comments upon the life of reserves, yes.

Q. You do not recall the matter to which I just referred?

A. I do not know the particular statement because we are producing hundreds of bulletins, as you know, and there are statements from time to time in various of those.

I would not want to say that I remember the particular statement that you are talking about.

Q. Well, does your company, Standard and Poor's publish a document called, "Industries' Surveys, Utilities, Electric, Gas and Traction, Basic Survey of the Electric, Gas and Traction Industries"?

[fol. 6603] A. Yes, we produce that.

Q. What is the purpose of this survey?

A. Well, the purpose of that survey, the particular one you are referring to is classified as "basic", which means that we write that particular sheet once a year in which we try to summarize all the more available statistics on the industries that you mentioned, namely, natural gas, electric and so on, utilities for such use as can be made by the investing public or anyone that might be interested in such study.

Q. Well, do you [intent] this to be published as reliable information and, also, advice for the investors, is that correct?

A. Well, we believe, as we qualify there in our qualifying note some place on the bottom of the last page, I think it is, it to be reliable. We do not guarantee any of it because it comes from various and sundry sources, press releases and some field investigation on our part, annual reports, interim reports and so forth, so it is no better than the source, in other words, from which we took it.

Q. Well, the note to which you have referred reads as follows, "The factual information contained herein has been derived from sources which are believed to be accurate but is not guaranteed. Opinions and forecasts are based upon careful analysis but are, also, not guaranteed [fol. 6604] and are subject to change without notice."

Is that the statement to which you just referred?

A. That is the statement to which I just referred, yes.

Q. Well, with that qualification, do you believe what is written in these industry surveys, published by Standard and Poor's?

A. Yes, that is as good information as we have.

Q. Now, there really is not any essential difference, is there, between the sources of the data upon which your company as the publisher of the "Industry Surveys" relies and that upon which you have relied in this proceeding for the purposes of your study which is contained in Exhibit 65? Is that right?

A. Yes, there is one fundamental difference, because here, as I have stated, we have gone back in every case to the original published annual report or whatever it was, confining it to the Panhandle Eastern Pipe Line Company.

That is a broad case covering every single company and industry mentioned in there and is not confined to one given thing at all. The result is that when we do it on this basis we get an exhibit of whatever the number of pages are here, whereas you are covering three different industries with about a hundred or so odd companies in 10 or 12 [fol. 6605] pages. That is one way to look at the difference.

Q. Well, I am going to read from Page U-1-16, Standard and Poor's "Industry Surveys" issue of May 14, 1941.

This page has the heading "Survey of the Gas and Traction Industries, Natural Gas". Then there appears another heading called "Reserves" and, also, a heading called "Estimates Increased".

This statement reads, "As has been the experience of the oil industry, estimates of natural gas reserves have increased as gas production has expanded."

Now, you have already stated that you agree with that statement.

A. That is correct.

Q. "The latest authoritative estimates of natural gas reserves in this country are around 100 trillion cubic feet distributed between the individual fields as follows:—"

Then, there appears a small tabulation in which the figures are headed, "Estimated Reserves, Trillion Cubic Feet", "Texas Panhandle and Oklahoma, 22.2, Kansas 18.0, California, 34.3, Gulf Coast and Louisiana 16.2, and Appalachian 7.0, Rocky Mountain 2.2, North Central 0.1, Total 100.0.

"On the basis of present consumption these estimates (which will doubtless prove conservative) would indicate a life of at least 40 years for the gas reserves. Thus, the question of over-all reserves need be given little weight [fol. 6606] in appraising the value of their securities."

Now, did you rely upon any of this information and data which I have read in arriving at your estimate of the 25 years as your period of amortization?

A. No, I did not and I do not think that has any bearing on this whatsoever. I would just eliminate that from consideration.

I say that for this reason:. That in that particular case we are talking generally about an over-all industry and those estimates there come from here, there and you, from no individual, but they are just a figure that someone put out to shoot at.

In this particular case we concentrated on the Panhandle Eastern Pipe Line Company and we were trying to get references in every specific instance that applied to this company, and none other, where we were talking about the company and that is the reason we referred to Ralph E. Davis' statement in the Registration Statement mentioned because he, there, was not talking about the Amarillo and California and so on territories, he was talking about the Panhandle Eastern Pipe Line Company and that is what we are talking about.

What you find in there, what you have read, has nothing to do with this company, so I say eliminate it.

Q. You fail to see any significance or any relation [fol. 6607] I should say, between statements which I read and the problem of determining the period of amortization for Panhandle Eastern Pipe Line Company. Is that right?

A. Where we have good figures, by a reputable man, on this company I say that those figures should be relied upon rather than general statements in regard to the overall industry, such as you read from the service my company produces.

Q. Well, do you know whether the Davis' estimate is based wholly upon the present reserves controlled by Panhandle Eastern Pipe Line Company and its vendors?

A. I was under the impression that the statements that he made there were such as to give him a reliable basis upon which to make a statement as to about the term of years Panhandle Eastern could see, so far as their own reserves were concerned.

Q. But you do not know, I take it from your answer, whether Mr. Davis based his estimate wholly upon present

reserves controlled by Panhandle Eastern and its vendors or not?

A. I am not sure on that point.

* * * * * * * * *

[fol. 6608] By Mr. Littman:

Q. Would it make any difference to you if you knew that Mr. Davis had based his estimate of "more than 25 years" wholly upon the reserves controlled by Panhandle Eastern and its vendors and had excluded from consideration the additional reserves which are available to [fol. 6609] that company, particularly in the Hugoton Field?

A. Well, Mr. Littman, on the basis of your statement I think we have to segregate two things. We have, first, as I understand it, the company which owns certain acreage and upon which estimates have been made as to M. c. f.'s that are available under the group.

Then, they are situated in a territory where there are many other hundreds of thousands of acres in which there are reserves which at some time might be tapped if their own reserves go out, but to get at these other reserves they must do one of two things, either buy the acreage and carry it until they need it or else at the time their own reserve exhaust make some arrangement whereby they can buy their necessary gas requirements from someone else, but which in one case will give you a much higher capital investment.

If you buy or if the best you can do is to lease or pay for M. c. f. as you take it, additional operating expenses to buy the commodity will result.

I mean it is not as if suddenly, if the estimates are accurate, you can pick up so many more M. c. f. without any additional capital expenditure.

Q. Well, without intending any criticism of the company's method of operation, it is a fact, is it not, that there is available to Panhandle Eastern additional re-[fol. 6610] serves which may very well extend its life far beyond the 25-year period which you used? Is that correct?

A. Very definitely there are those acres and that available M. c. f.'s but the company cannot bring that into its

invested capital picture until it either lays out a large sum of money to buy the acreage or else contracts by lease to take over the acreage.

In any case your invested capital is going up by the amount of those items.

Q. Would your same answer apply with respect to the amortization of your main pipe line?

A. Well, in the case of the pipe line it seems to me that you have got a different situation. Where you are talking about the pipe line, you are talking about a mental situation and not a particular natural resource in the ground.

I do not quite get that comparison.

Q. You are dealing with dollars that have been invested in the main pipe line?

A. That is correct.

Q. Which, incidentally, makes up the larger portion of [you] invested capital?

A. That is correct.

Q. Is that right?

A. That is right.

[fol. 6611] Q. Now, if the life of these fields is going to extend beyond 25 years, you certainly would use a term larger than 25 years for purposes of determining amortization of the pipe line, would you not?

A. Well, that depends upon the circumstances. After all, where you build a pipe line and issue bonds, you have certain other calculations to make.

Q. Well, let's assume, in order that we may determine your method of procedure, that the life of the Hugoton Field was 50 years.

What figure would you use for amortization purposes in this case?

A. Well, that is partly determined, as I say, by the way the pipe line was financed. If the pipe line was financed by bonds, you have to have provisions in your bonds as to how the pipe line will be amortized and there is relationship of that to the gas supply and that depends partly on how the conditions are worked out at the time.

Q. In other words, if I correctly understand you, it is the provisions in the bonds that govern the period of amortization?

A. Well, not altogether. What I am trying to point out is that you have reserves on the one hand to consider, you have the pipe line as a different thing to consider and you are going to finance the pipe line.

[fol. 6612] Now, that takes money and this company got it from the public. Now, it depends upon conditions at the time the money is secured from the public as to what kind of provisions you have to put into the particular security to get the market to supply these funds.

Now, if the market at the particular time is such that the reserves seem adequate and you can see a full life for the pipe line, they will try to work out the amortization on that basis, but if they cannot they will make such adjustment in there as will give such added additional protection to bondholders as that given group of monied people, so to speak, require in order to put their funds in to finance the pipe line.

Those things are delicate matters that have to be worked out. They are not straight arithmetical matters, nor can a man sit down and tell you the answer right now.

There are many angles to that thing that have to be figured out and it is not a simple mathematical calculation.

Q. Well, yours is a very simple mathematical calculation in Exhibit 65, is it not?

A. Certainly, but I am not starting a new company here nor is the Panhandle Eastern. The company is in existence, the facts are all known.

Q. Do you claim any real accuracy for this figure of \$2,541,034 for "Return of Capital When Gas Reserves are Exhausted"?

[fol. 6613] A. Let's put it this way: I stand 100 percent on that figure until someone produces an engineering estimate which proves conclusively that it is wrong.

Q. I would like to understand your reasoning in arriving at this figure. I am asking you to assume that the

gas reserves of the fields in which Panhandle Eastern is operating are going to last 30 years instead of 25 years.

What term would you then use for purposes of determining the proper amortization allowance?

A. Mr. Littman, I thought I had answered that by saying that if Ralph E. Davis or some other reputable engineer had stated some other figure than 25 as directly applied against the Panhandle Eastern, under my method I would have applied that figure.

Now, because of the fact that Ralph E. Davis said 25 years, I took it. He said, "25 years or more", but the fact that he said "25" indicated to me that he thought there was a possibility it might be fully exhausted by then, it was a possibility.

If that is the case, I think there is every argument for using that figure. If he had thought 50, he would have said 50 or more or 30; he did not say that.

Q. And for purposes of this study you were not interested in whether there were other gas reserves available [fol. 6614] than those reserves which Panhandle Eastern presently owned and controlled?

A. Mr. Littman, I know there are other gas reserves. I have been all through this territory, not making a survey, but I have traveled through the country and know something about its layout and so on.

My statement is that although these other acreages are available with their various estimated reserves, when the time comes that they are needed before Panhandle Eastern can have access to them their acquisition is going to cost this company more money.

Now, I say either they will go out and buy the acreage, in which case their invested capital goes up so you have more to amortize and you may come out with exactly the figure of $2,500,000 although you are talking of $125,000,000 invested capital instead of $60,000,000 or some other figure, or, if they do not go out and buy the acreage, they then must go out and lease it, in which case they have charges against operation for leases to acreage they are not now using which will cause their cost to go up.

Now, you cannot, it seems to me, talk in terms of those things and still be talking in terms of $63,000,000, because the $63,000,000 is no longer your base.

Q. Well, are you assuming that Panhandle Eastern is going to cease its exploration of gas after June 30, 1941, [fol. 6615] and stop leasing new acreage?

A. No, but by the same token I see no reason for the management to go out and take on another 100,000 or 500,000 acres with whatever the estimated M. c. f.'s are if they do not need the gas right now.

Why should they pay the additional cost of carrying all that acreage if they do not need it, unless they are fearful that next year or the year after their own reserves will be gone and they must tie this up before someone else gets that same acreage?

The only point I am trying to make is, Mr. Littman, that you cannot go out—all these acreages are around and the M. c. f. is there—and get it and still have $63,000,000 on the books.

You are going to have $63,000,000 plus.

Well, you tell me the figure and the years and I will divide that total and I do not know whether I get $2,300,000, $2,500,000 or what.

Q. Well, Mr. Coffman, if your advice is followed, the company is going to have $2,541,000 each year, a large portion of which is intended for the purpose of replenishing its wasting assets, is that correct?

A. That is correct.

Q. What does it intend to do with that money?

A. It eventually, when the time comes, whether it is [fol. 6616] that money or some that they have segregated for refinancing, will go out and buy such additional acreage as is necessary.

Q. And to the extent that $2,500,000 is returned each year under your method—well, of course, the property is depreciating to that extent each year, is it not?

A. It is being exhausted to that extent.

Q. It is being exhausted to that extent?

A. Yes.

Q. And this amount measures approximately the amount of that exhaustion, does it not?

A. As we have used it, it does.

Q. And so your rate base or your base of invested capital need not change at all through the years, need it?

A. Well, no, that is just absolutely not true.

Q. What is wrong with it?

A. This is wrong with it: The company, as I see it, is not tatic at one point and does not remain that way for 25 years, let us say, nor say, "Well, we have washed ourselves up, let's start over".

They are maintaining the property day in and day out as we go, price levels are changing, everything else is changing, they go over and buy some new acreage they are wanting to deal on.

They may take a few thousand acres and so on it goes day in and day out. It is not a question of where you have [fol. 6617] a situation there and we say, "Go for 25 years, if it is exhausted we will start clean and fresh". This thing goes on hour by hour during the working day.

Q. I think I understand your theory now, Mr. Coffman. Your amortization term is based, according to your theory, upon the amount of reserves presently controlled by a given company and not upon the life of the fields in which that company operates. Is that correct?

A. The amount of the acreage that is controlled by the company and the actual reserves is the only investment that that company has.

Q. The answer to my question is, yes that is your theory?

A. That is exactly right. I do not believe it can be otherwise. That is the investment of the company. I would like to amplify that answer on this score, again, to repeat myself, that you have, as you go on expanding your reserves although they are there, to make further investments and those investments may cost you more or cost you less and I do not think anybody can dodge that issue.

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[fol. 6622] PAUL B. COFFMAN a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Cross-Examination (Continued)

By Mr. Littman:

Q. Mr. Coffman, at the close of the last session, we had been discussing your allowance for an annual provision to return capital to investors when gas reserves are exhausted which is shown in Chart No. 31 of Exhibit No. 65, and I believe you testified that the sum of $2,551,034 shown in Chart No. 31 as "Projected" annual amount, was obtained by dividing 25 years into the invested capital in the amount of $63,775,839, is that correct?

A. Yes, sir.

Q. And is my understanding correct that the $63,775,839 represents the total of the outstanding securities, to-wit, bonds, preferred stock, common stock and surplus as [fol. 6623] of June 30, 1941, under your assumption of refinancing?

A. Yes, that is correct, or as shown in Chart No. 27 of Exhibit 65.

Q. Before going to the next question, I would like to make certain my understanding is correct that this annual provision of $2,551,034 which you term "dollars needed annually by Panhandle to return capital to investors when gas reserves are exhausted", is for the purpose of covering the annual depreciation, depletion and amortization allowances?

A. That is generally correct. It is the amount annually that would be necessary to fully compensate capital for the amount invested in the estimated length of life which, in this case, was taken as 25 years.

Q. Well, you intended it to cover all three items which I named, to-wit, depreciation, depletion and amortization?

A. That is correct.

Q. When did Panhandle Eastern Pipe Line Company first [connence] its operations?

A. Well, as I recall, it actually commenced operations in the early part of 1934. The company was originally formed in 1932.

Q. I hand you a copy of Exhibit 49, which is the com- [fol. 6624] pany's income statement per books as presented

in these proceedings by Mr. Watkins, and ask you to refer to that for the purpose of refreshing your recollection on the subject.

A. Well, from this Exhibit 49 on Schedule 1, it is indicated that there were revenues as of December 31, 1932, covering the period April 1 to December 31, of that year.

Q. That indicates, does it not, the company was operating at least for a time in 1932?

A. That is right. It was formed in 1932, but when you said "operating", I interpreted that to mean when it really got under way as a pipe-line company and I believe it was in 1934 that it really began to function.

Q. Panhandle Eastern Pipe Line Company was incorporated sometime prior to 1934?

A. I think I can give you the exact dates on that question.

Q. I believe you show that in your exhibit?

A. The company was incorporated in 1929, December 23, as the Interstate Pipe Line Company and it adopted its present title on May 9, 1930.

Q. At any rate, it is your understanding that Panhandle Eastern Pipe Line Company did not commence operations as a pipe-line company until 1934?

A. No, that was not what I meant. It was organized [fol. 6625] at the date I have read but, actually, for a company which was transporting gas long distances on a profitable basis, the company really did not get under operation, as I remember it, that is, fully, until 1934 and it was not until they had the Detroit contract in 1937 that it went on to a large-scale basis.

Q. Mr. Coffman, I hand you a copy of Exhibit 52 which was presented in these proceedings by Mr. Watkins, which shows the gas plant of Panhandle Eastern Pipe Lina Company and subsidiary companies for the years 1930 through June 30, 1941.

What is shown on that exhibit to have been the amount of gas plant as carried on the books of the company in 1930?

A. A total of $44,432,256.86.

Q. What is the total for 1931?

A. $56,414,134.

Q. That indicates, does it not, that Panhandle Eastern Pipe Line Company had a substantial investment in gas plant in those early years, is that correct?

A. Yes, that is correct, but when I said "operations", I was looking at it more from the income standpoint and from the study we have made here when we started tabulating the facts in 1934.

Q. Mr. Coffman, when I used the term "operations", I had reference to that term as it is used in the Com- [fol. 6626] mission's Uniform System of Accounts.

Now, there is not any question about the fact that Panhandle Eastern had commenced operations within the meaning of the Uniform System of Accounts as early as 1931, is that correct?

A. No, that is correct.

Q. Now, as of what date do you commence amortization of the total invested capital as reflected in Chart No. 31 of Exhibit 65?

A. You are referring now to the $2,551,034?

Q. Yes, sir.

A. In that particular case, the calculations that were made were to determine the annual amount of deduction that would be taken from gross operations and that figure is merely the annual charge, irrespective of what time it was taken.

I mean the annual rate, after all, so far as the operating statement is concerned, has nothing to do with the number of years that you are talking about, once you have discovered what the particular figure is.

Q. You use a period of 25 years, do you not?

A. I use that merely for the purpose of determining the $2,551,034 and then when I proceeded to make up the projected figure which is shown in Chart 37, that was the amount that was used as the deduction from gross revenue [fol. 6627] for a return of the exhausted capital.

Q. But your 25-year period commences as of June 30, 1941, does it not?

A. Because it was based upon $63,775,839, which was the amount at that time under the assumption that I made.

Q. In other words, your term of years commences, as applied by you, to run from June 30, 1941, and your base to which you apply your years, which is the total invested capital as represented by the outstanding securities is also as of June 30, 1941, is that correct?

A. That is correct.

Q. Well, if you were making this study as of June 30, 1942, what would you do in respect to making your determination of annual provision for returning capital to investors when gas reserves were exhausted?

A. Well, I will answer that in two parts:

So far as the method is concerned, I would do exactly the same thing.

So far as the figures are concerned, I would want to review the situation. If I discovered that 25 years continued to appear to be the proper and most reasonable estimate to use, then I would use 25 years against the then invested capital of the [of the] firm.

If it were different than the $63,775,839, I would take into consideration that portion, but it must be clearly [fol. 6628] understood that in the $2,551,034, there have been past accumulations, obviously, for the prior years in which the firm operated because, obviously, you begin to amortize from the time you have any exhaustible reserves which are actually exhausting as you proceed to operate, so that the $2,551,034 is not an entirely new figure.

It is merely a sum total of figures that you have gotten as the conditions within the business have changed from year to year.

In other words, as you add on more reserves and exhaust more reserves, naturally the figure changes, but a great portion of the $2,551,034 was already taken into consideration.

Q. And I understand you to say that you would, in making this study as of June 30, 1942, first do the same thing that you did here, namely, take the outstanding total invested capital as represented by the outstanding securities and surplus and divide by how many years?

A. I said 25 if that was still the best estimate that was available.

Q. You would still use 25 in 1942?

A. Well, no, there is where I apparently do not make myself clear.

I am saying that if from one year to another conditions in the business have changed so that you have added additional invested capital, that portion has to be amortized. Obviously, already in the $2,551,034, you have considered the capital that was existent up to June 30, 1941.

You have already established a rate on that so you continue to apply it and the annual rate for that portion will remain the same but, for the additional capital that was added between June 30, 1941, and June 30, 1942, you will make a study of that to see what the amortization rate is.

Q. Do I understand you would or you would not use the same method in 1942 that you used in your Chart No. 31?

A. Yes, I am using the same method but not necessarily the same figures for all of it because, if the total capital is changed, obviously, there is a new factor to be considered.

Q. Assuming there were no new estimates of gas reserves and no capital additions, how would you compute the allowance as of June 30, 1942?

A. If there had been no changes at all since I had started out with a straight line annual deduction of $2,551,034, there would be a deduction for $2,551,034 as of June 30, 1942.

Q. Now, in other words, it would be 24 years divided into the invested capital figure?

A. The net invested capital figure.

[fol. 6630] Q. That is, another way of stating what I understand you to say, is that you would deduct from the net investment figure the $2,551,034 which had been allowed for the year ended June 30, 1942.

You would deduct that from the gross investment figure and you would then divide the balance by 24, would you not?

A. From the property standpoint, yes, that is what it amounts to.

Q. You just stated that would be the way to do it from the property standpoint. What would be the way to do it from the standpoint of invested capital?

A. I do not recall stating at the time of the direct testimony, but there are two ways that one can calculate invested capital.

You can take the net property plus the intangibles and working capital, or you can take invested capital. In this particular case, I took the invested capital because, using the annual reports, it seemed to be a simpler way to proceed; so when you are talking about exhausting the property, you, as referred to in the language used as depreciation, depletion and so forth, apply that against property as such, and not against capital because, after all, as you take these deductions, the charge which you make is first converted into cash and from there is then converted into other assets as you continue as a going business and that [fol. 6631] continues on as long as the firm continues to exist.

Q. Are you or are you not claiming that the method followed by you is the correct method for rate-making purposes?

A. I say it is one very good method for rate-making purposes, absolutely. I do not want to be misunderstood on that.

Q. And you say it is proper and correct to do it in the way you suggest?

A. Yes, as a method.

Q. Well now, let us say that you are making this study as of June 30, 1942. Assuming that the estimate of gas reserves which you used and adopted from Mr. Ralph E. Davis' study was the same, how would you go about making your allowance?

The Witness: Would you read that back, please?

(Whereupon, the pending question was read by the reporter.)

The Witness: On that, if all factors remained identical, as I say, I have already, as of the date of this study which is a year preceding the date you are assuming, established an annual rate of $2,551,034, and having elected to take

a straight line deduction, that amount for that identical capital will remain the same for 25 years unless, in the meanwhile, new conditions developed where it would be indicated that the relationship of the figures changed and [fol. 6632] you would have to make a change in your accounting.

In other words, for example, suppose that we, after the tenth year, let us say in 1950, found that the reserves were all gone on this particular amount that was included in the $63,000,000.

Obviously, the accounting method would have to be changed at that point and adjustments to surplus made and so forth, to take into account that fact but, assuming the conditions are identical from which I start and assuming that year after year these reserves go on in the ratio of 1:25, then the amount is $2,551,034 for that amount of capital in the business as of June 30, 1941.

Q. Under the assumption which you just made, the investors will have received $2,551,034 for the preceding year, is that correct?

A. Well, it really isn't that simple, Mr. Littman, because, as I have just tried to indicate, when you have a going concern, if you make deductions of $2,551,034, you do not take that out and pass it right back to the original people that invested the original capital, as you know.

The deduction, as I say, for all practical purposes goes through the cash account. That cash is reinvested in the business to keep it a going business.

Part of that cash may be for new equipment, new booster stations, new gas reserves, leases or acreage and so forth, [fol. 6633] so that no, they have not got it back directly.

All that has been done is to allow for it to keep this property going to cover the capital they originally had but, in any event, the investors who put money in this business certainly want to be assured that there will be sufficient assets there in some form to cover the amount of their original investment in what seemed to be the reasonable estimated life of the property when they first made the investment.

Q. Well, let me ask you this: Would it be proper, in making this study as of June 30, 1942, to do what you have done here, namely, to divide the total outstanding securities and surplus, meaning invested capital, by the remaining life, according to Mr. Davis' study and as interpreted by you of 24 years as of that date?

A. Well, apparently I am unable to get across to you a distinction that has to be made.

Q. You will help me a lot if you will state whether that is what you would do in June 30, 1942.

A. The only way that I can say that it is, is to say that, if every single condition and factor remained identical with June 30, 1941, I will say "yes", but that is an impossible situation or at least I think so.

Q. All right. You would then, under the conditions which you have described, divide the $63,775,839 of in- [fol. 6634] vested capital by 24, is that correct?

A. No, that is not correct, because you have just already, in the first year, taken out $2,551,034, and you have said that the length of life is 25 years.

You are taking one-twenty fifth out of each year, so the second year you certainly could not divide the original amount of invested capital by 24 and get the same result.

Q. So you would deduct the $2,551,034 from the $63,775,839 in June 30, 1942, before you make your division?

A. That is correct.

Q. By the 24 years?

A. That is correct, but that still leaves the question wide open because it is not that kind of a situation and never could be unless you had a straight liquidating firm.

Q. I presume your answer would be the same with respect to the next succeeding year, being 1943, and you would then make the deduction of 2 times the $2,551,034 for the two years, is that correct?

A. That is correct.

Q. And then you would divide the balance by the remaining 23 years?

A. Yes, still qualifying such answer by the statement that assuming all conditions remain 100 percent identical throughout.

[fol. 6635] Q. And if you got down to the very last year of the purported life of this property, that is, down to

the 24th year, you would have only $2,551,034 left to be amortized in one installment, is that right?

A. If all conditions remained identical, nothing had been added or taken away from the property, that would be correct.

Q. And it follows that after ten years have elapsed from June 30, 1941, you would deduct $25,551,000 from your $63,775,839 and divide that balance by the remaining 14 years, is that right?

A. That is correct but I qualify my answer again to say that the assumption that you are making just is not in accordance with any of the facts and cannot be with a going concern.

It is impossible, so I do not see that the point you have been making is pertinent to the particular analysis and the method of approach that I have used.

Q. Are the deductions which I have suggested in accordance with the theory of straight line depreciation?

A. They are in accordance with that, but you have set up conditions which cannot possibly exist, namely, that all these conditions must remain identical, one year to the next.

Q. Do you mean to say that the straight line theory [fol. 6636] cannot be applied?

A. No, I do not say that at all, not in the least.

Q. Well, you do not deny that in each succeeding year you have got to make a proper allowance for the diminution in the property as represented by the annual provision to take care of the wasting away and the amortization of the property, is that right?

A. Yes, I agree with that.

Q. Now, will you tell us where you have made such a deduction in your calculation which is reflected by Chart No. 31 for any depreciation which has accrued on this property down to June 30, 1941?

A. I am not sure that I understand the whole of your question but, as much as I understand of it, Mr. Littman, the answer is this:

It seems to me that your question applies principally to the balance sheet, as I understand it, in which I think you are driving at the point that there has been a re-

serve for depreciation and amortization built up on whatever the invested capital was from the April date in 1930 over to June 30, 1941.

Now, the balance sheet item is one part of the equation but from the standpoint of Chart No. 37 which we have been discussing and the annual deduction of the $2,551,034, that is, from an operating income and expense point [fol. 6637] of view, wherein I was trying to determine the amount of dollars necessary that the management would have to have to render adequate service to the public and maintain the credit and that amount of $2,551,034 has already been explained as to calculation and would be the amount that would continue to be deducted.

In other words, I still come back to my original explanation that whenever you deduct from operating expenses any items which are in the nature of a return of capital, you do not actually, in most instances anyway, return that capital directly to the investors.

What you do is have that amount automatically flow through the cash account to be reinvested in the business and it is continuously being reinvested in the business so long as you have a going concern.

If you arrive at any point where you are then becoming a liquidating concern, presumably with no new investments, you proceed to pay out as quickly as you can wind up the business.

Mr. Littman: I am going to ask that the question be read again.

(Whereupon; the question indicated was read by the reporter as follows:

"Q. Now, will you tell us where you have made such a deduction in your calculation which is reflected by Chart No. 31 for any depreciation which has accrued on this pro- [fol. 6638] perty down to June 30, 1941?")

The Witness: Then I will have to ask you, if you can, to elaborate your question, as to what your meaning is. If I understand your question to mean one has a reserve for depreciation, amortization and so on set up upon the books, the answer is "yes."

If you further mean has that amount or should that amount be deducted from the gross property, the answer is "yes", but those two answers relate to balance sheet considerations only.

I was not, in Chart No. 37, talking about the balance sheet. I was talking purely about the profit and loss or operating statement. I think I have answered your question directly, as I understand it.

By Mr. Littman:

Q. Are you suggesting that the company's operating statement and balance sheet cannot be reconciled for rate-making purposes?

A. Not in the least. I do not see that I even raised that question.

Q. In my opinion, Mr. Coffman, you have not answered my question. I asked you to point out where, in your calculation of this $2,551,034, the annual amount which you claim is required to return capital to investors when gas reserves are exhausted, I asked you where, in that simple [fol. 6639] calculation, did you make any deduction for the depreciation that had been accrued in the preceding years for that same purpose?

A. And my answer to you is that you are talking about balance sheet consideration, whereas I, in Chart No. 37, am talking about profit and loss considerations and I cannot show you in Chart 37 because there you talk about one year and one year only at a time, so far as these figures are concerned and which is true of any profit and loss statement, as you know.

Q. I take it your answer to me is that you cannot do that, namely, you cannot show me where you made any deduction for the preceding year's depreciation, depletion and amortization?

A. My statement is for this particular calculation there are certain operating expenses necessary to render the service, that is, the service to the consuming public and maintain the credit position of the company.

Those are purely operating considerations which are usual and always expressed in a profit and loss statement and each of the items taken there were the best estimate of the annual amount that had to be set aside to maintain

this service and maintain the credit and you cannot find, in Chart 37, any accumulations of anything just the same as you cannot find, in any profit and loss statement that I [fol. 6640] ever saw, any accumulations except those shown for the twelve months or except as the statement varied in the twelve months.

A profit and loss statement is not to accumulate anything except the current charges accumulated in the twelve months period.

Q. You cannot tell me wherein you made the deduction?
A. None was made in Chart 37 because here we are talking about the annual allowance in the profit and loss statement since this particular profit and loss statement covered the particular period of a year.
Q. Now, Mr. Coffman, as you have indicated, it would not be proper to, ten years hence, divide the total invested capital, as represented by the outstanding securities and surplus, by the remaining purported life of 15 years, is that correct?
A. No, that is not correct because—maybe your intention is all right, but I do not think your question indicates it—because I have said and I repeat again that the only way your statement could be true is if all conditions and factors remained identical but that is impossible in a going business and all I am trying to do, Mr. Littman, is to indicate that as you go ahead and you subtract, deduct something for amortization of capital in one year, if you trace that through the operating statement in any profitable firm, it is converted to cash. That is the first step.

[fol. 6641] Then the cash is used for operating purposes in the firm to make new capital commitments, maintain the property and so forth, so that, day in and day out, this thing is changing so that at the end of ten years, you do not divide by 15 because you do not have the same amount.

It is impossible in a going concern. It is just absolutely impossible.

Q. Well, are you suggesting that this method of yours of simple division of the remaining years in the total invested capital is not the proper method from here out?
A. I have not said anything like that up to the present.

Q. Let's see if I can understand you now.

What you did here in this proceeding was to take the total outstanding invested capital as represented by the outstanding securities and simply divide by the remaining number of years. Is that right?

A. Divide by the estimated life at that time, yes.

Q. Now, would you do that same thing next year or would you not, if you were making a study for rate-making purposes?

A. I think I have answered that question once before in these terms: That if next year came to pass and the best estimate of the length of life that I could get at that time was 25 years, I should apply 25 years against any [fol. 6642] increments which had been added to the invested capital from June 30, 1941, to June 30, 1942, but for that particular amount of invested capital which had already been on the books and remained on the books, there would be no reason to change the rate unless I found that the 25-year engineering estimate which was made originally was seriously at fault and I say that in a going concern, you must divide those two things because day in and day out there is additional capital worth in this investment.

It was $44,000,000 one year and it was $55,000,000 the next and it is now up to $63,000,000. There are items being added all the time.

Q. And you would, next year, make a deduction of $2,551,034 under those conditions, is that right? Would you or would you not, under the conditions which you assumed of no change?

A. Just a moment. I would deduct the $2,551,034 as a deduction relating to the original $63,775,839 but, if from June 30, 1941, to June 30, 1942, there had been changes in the business so that the invested capital was then, let us say, $65,000,000 in round figures, that additional $2,000,000 which had gone into the business would be computed like we computed it originally, that is, so far as the method is concerned.

We take a look at that particular portion and if the best [fol. 6643] engineering estimates you could get were still 25 years, all right. I would start then and take one-twenty fifth but if in that one-year interval, engineering estimates indicated there had been a change so that it should be one-fifteenh or one-thirtieth, let us say, I would use that and I believe that is in keeping with sound accounting procedure.

Q. I would like to discuss with you for a moment the theory of straight line depreciation, Mr. Coffman. Have you applied the straight line method of depreciation here?

A. In this particular case, so far as the return of capital is concerned and so there won't be any confusion in phraseology, I think I understand accounting language but maybe I am wrong; but the phrase "straight line", whether applied to depreciation or anything else, as I understand it, means that you know the depreciable asset value at hand.

You make an estimate as to its length of life. You divide that value by that length of life and thereby get an annual deduction which is the same figure year after year for the estimated length of life.

That is called a straight line method. That is what I understand to be a straight line method.

Q. Now, assuming that a property commences operating with \$35,000,000 of invested capital and it has a 35-year over-all life, am I correct in stating that when that property is 10 years old, it has a remaining life of 25 years [fol. 6644] and that under the straight line method, \$10,000,000 will have been accumulated in its reserves?

A. That is correct.

Q. And when you come to the tenth year of the life of this property, you use what figure for purposes of making your division?

A. Well, Mr. Littman, it all depends. I could do one of two things and what is commonly done in all accounting practice that I know about is, you set up on your books an asset account originally which had \$35,000,000 in it and, in order that you can keep track of that accurately throughout the 35 years, the \$35,000,000 remains as a debit to that particular property account.

In the meanwhile, you take out the one-thirty fifth each year and put it in a reserve. For all practical purposes, that reserve is merely the credit side of the property account.

However, it is not shown that way. It is shown on the liability side usually of a statement or, more accurately stated, it is shown as a credit to a reserve account and that reserve, however you show it, whether you show it on the liability side or whether you show it as a deduction on the asset side makes no difference but, nevertheless, you take one-thirty fifth of that original amount until the original amount is exhausted.

[fol. 6645] Now, if you wish to call it net and make the deductions each year, then the number of years you go you will divide the net amount by one—whatever the number of years left to go is—although I have seen very few situations where anybody has handled their accounts that way.

Q. Well, Mr. Coffman, when the property is 10 years old, you certainly do not divide the original amount of $35,000,000 by the remaining life of 25 years, do you?

A. No, you established a rate when you started and if the rate proves to be accurate through the years, you continue to use it.

The only time you would ever change it is when a new engineering investigation would indicate that the original estimates are all wrong and then at that time surplus accounts are adjusted, reserve accounts are adjusted and a new rate is determined for the then net balance remaining in the asset account.

Q. Now, under my hypothetical case of a $35,000,000 invested capital at the beginning and an over-all life of 35 years and under the further assumption that the property is now 10 years old, you are still deducting $1,000,000 a year, is that right? Can you answer that, yes or no?

A. Thirty-five years, $35,000,000, $1,000,000 a year, that is right.

Q. Yes, and the balance of the property account, that [fol. 6646] is, the net investment as of that 10th year is $25,000,000, is that correct, under the calculation?

A. At the end of 10 years, $25,000,000 balance, that is correct.

Q. Would it or would it not be proper, Mr. Coffman, to divide the original amount of $35,000,000 in the 10th year by the remaining life of 25 years?

Can you tell me whether it would or would not be proper to do that?

A. You mean divide the original amount by the number of years then left to run?

Q. Yes.

A. No, it would not be proper.

Q. That is what you have done here, in effect, haven't you, Mr. Coffman?

A. No, not at all and I will take your own hypothetical situation and show you why, I think.

If you have $35,000,000 that you invested originally in a property, as I say that goes into a property account as a debit to some particular asset account.

At the end of 10 years, so far as that particular original $35,000,000 of property is concerned, if the rate of $1,000,000 per annum proved to be correct in each of those ten years, $10,000,000 has gone. It has been exhausted.

However, when you make a deduction in your operating [fol. 6647] statement for amortization or depreciation and such business is operating at a profit, you have a sales account, as you know, which gives you gross revenue.

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From that you make deductions. You have a resulting profit. The gross revenue was an account receivable. The account receivable was paid in cash. The cash was invested in other various means of operation so that, as this firm went on, whereas you say they have only $25,000,000 left, it is very possible and most likely that by the flow of that cash, the $10,000,000 has been reinvested in the property so that there is still $35,000,000 worth of property in that business and not $25,000,000 and that belongs to the original owners and I contend that is 100 percent sound and is the way every business in this country is operated.

Q. What you are saying is that the company is, in reality, entitled to have amortized the net investment in

property used and useful in the public service, is that right, over the remaining years?

The Witness: Will you read that question, please?

(Whereupon, the pending question was read by the reporter.)

The Witness: I think, if I can state what I believe to be what you are getting at it will help me if I am correct in this understanding.

If you mean to say that the original investors in this [fol. 6648] property put in $35,000,000 and that when depreciation has exhausted the $35,000,000, irrespective of whether or not the items that went through the reserve are reinvested in the business, that the original investor no longer has any equity in the business, then my answer to you becomes very clear.

After all, the original capital was supplied by bonds. So far as I am concerned, that is a contract with the public. It was done by preferred stock which is also a contract with the investing public and the common stock and if those securities were sold to the public on a basis where it was not understood that, at the end of 20 years, they were to be paid off and everybody would be free and clear, I say that the theory does not hold unless it can be established in court that that is perfectly all right.

As I understand, most of these investments that are made, the people put in the money with the understanding, except where it was a bond which said, "At the end of 50 years", or whatever the maturity date was, that they would be paid off, all of the other investment of the common stock and preferred stock and so forth was to stay invested and as the items go through reserve and are reinvested, that is exactly the contract that those people made.

Until it can be squared off that the preferred and common holders are paid and they are told, "Here is your [fol. 6649] money back or until you have the money back there is no investment", I do not think there is a leg to stand on.

The capital is still there. That is my contention and although you have a reserve, it was reinvested. It is a work-

ing asset in the business and a working capital in the business.

The people still wanted their interest. They wanted a common dividend or preferred dividend and they have received that but that was not a return of capital and the only place that would be true would be in sulphur companies where they have followed the accounting procedure of an exhaustible asset and they are told, "This dividend you are being paid, one part is return of capital and the other is by way of income" and if you have not stated that, it seems to me it has to be settled in the courts before you can start doing it.

Q. Are you assuming that every dollar of this depreciation reserve which has been accumulated by Panhandle Eastern Pipe Line Company has, in fact, been reinvested in the business?

O. It is all in the business right now, Mr. Littman.

Q. Some of it is in the bank, isn't it?

A. There is some cash in the bank but every business has to have cash in the bank to operate.

Q. Some cash—do you know how much cash there was [fol. 6650] as of June 30, 1941?

A. I think so. Yes, the company, as shown in the condensed consolidated balance sheet as of June 30, 1941, and this is the unaudited statement of Panhandle Eastern Pipe Line Company and its subsidiary company, had cash of \$7,042,691.65 and special deposits of \$1,489,127.23.

That, let us say, is a total of around, well, about \$8,550,000 in round figures.

Q. Now, it is your testimony that the investor is entitled to have the amount of \$8,500,000 of cash in the bank amortized, too? Can you answer that yes or no and then explain it, if you wish?

A. I will answer "yes" on this basis, absolutely. This cash is not as if it were a gold bar down in the basement of the Federal Reserve System which we can plant there and forget.

They have this amount of money but deductions are being made every day and additions are being made every day. For a firm that has an invested capital and doing ap-

proximately $15,000,000 of business, I say has to have this much cash.

Further than that, this company has mortgage bonds of one kind or another outstanding. That is merely a working asset.

Unless person or the Commission can show me that amount is excessive, I say absolutely it is a working asset [fol. 6651] and should be included in the figure.

Q. And an allowance should be made to amortize this $8,500,000 of cash in the bank over the remaining 25 years?

A. Because—

Q. (Interposing) Is it "yes, because"?

A. Yes, because it may be next week I am ready to put in a new pipe line or a new looping of the pipe line. It may be in a booster station.

Q. And it may be declared in dividends too, is that right?

A. All of the corporate assets which are liquid can be declared in dividends, if the management believes that the conditions of the firm are such that a dividend is warranted and the amount they select seems to be reasonable.

To put it the other way, the figures I have used for capital requirements is going to be even higher because the people do not invest their money to get no return.

If the Government wants to finance these utilities so that the public won't have to do this, that is another matter. That is something else again.

Q. Do you think that dividends should be amortized too?

A. I do not see what your question means. Dividends are a cash outgo and a company that has mortgage bonds outstanding of the amount that you have here, has preferred stock [outstandin] in the amount you have here [fol. 6652] and common stock, certainly if it wishes to maintain its credit to the public must conduct its operations that there will be something available by way of current earnings from time to time to meet the interest unless they want to default on their securities, to meet the dividends on their preferred stock unless they want to

go into arrearages and something for common and that is not an unusual corporate practice in any man's language.

Q. It is your testimony, I take it, that working capital must also be amortized over the purported life of the gas reserves?

A. I say that the amount of invested capital which is represented by money put in by investors or someone must be accounted for and, in order to maintain your credit position and to get it back, these various items must be taken into consideration.

Q. And then your answer to my question is "yes"?

A. On the invested capital, yes.

Q. And is your answer "yes" on the working capital, that it must also be amortized?

A. It is not in the invested capital, Mr. Littman. In invested capital never, to my knowledge, there is never included the sum total of working capital.

After all, it is current assets against current liabilities, [fol. 6653] whereas the invested capital is bonds, preferred stock and common stock plus surplus.

Q. Didn't the investor put up money for working capital as well as for the other property?

A. He did and originally it was accounted for, but as you go along and make earnings or make losses, those proportions are changed and you have to take that into consideration. It is not a status quo figure at all.

Q. Whatever working capital is included in the invested capital figure of $63,775,839 which you used, you have provided for amortization, have you not, to that extent?

A. To the extent that it is there. I think I can make a calculation to find out what it is, as a matter of fact.

Q. All right.

A. On the table for Chart No. 11, I show there the calculations related to your question, up through 1940 from 1934, and show the property, plant and equipment of $64,854,956 less the retirement, renewal, depreciation, amortization reserves of $9,189,501, giving the net property of $55,665,455 and then the intangibles which include the gas sales and purchase contracts of $2,051,434 and below, the net working capital which amounted to $2,205,097, giving the total invested capital of $59,921,986.

Now, to the extent that the net working capital is in- [fol. 6654-55] volved, all right, but that is not the $8,000,000-odd you were talking about in cash.

[fol. 6656] Q. Well, what was the net working capital figure as of June 30, 1941? I think your table for chart No. 14 will show that.

A. The net working capital as of June 30, 1941, was $4,661,875.

Q. And you are amortizing, in your calculation, that amount of net working capital which you just named; is that correct?

A. Yes, I am, because I say that that is absolutely needed to keep the wheels turning in this business and maintain it as a going concern, and it represents active invested capital.

Q. And in addition to amortizing the amount of $4,661,875 of working capital, you also require a return upon it, do you not?

A. What kind of a return? Do you mean a return of it?

Q. A return upon it. That is, you tell us how much money is required to raise securities to cover that amount as well as the other amounts in the property accounts.

A. Yes, I do, because although that may be liquid, Mr. Littman, it is just absolutely as essential to keep this business going as a booster station or the eight hundred or more miles of pipe line or the gas reserves down here. The gas reserves without the pipe line and without this par- [fol. 6657] ticular margin of working capital couldn't function.

Q. Well, doesn't it strike you that $4,661,875 is a rather large amount of working capital for a company of this size?

A. Why, as of June 30, 1941, I wouldn't say so. At that time there were questions, for example, about further needs for looping the line, other expenditures that were going to have to be made, the question of the Michigan Gas Transmission system and so forth. It doesn't seem to me that that is anything out of line at all, included in current working capital requirements. Further than that, I point out that as all balance sheets show, they give you the figure as of a given moment of time. As of June 30, 1941, it might have been $4,661,875.

Q. Well, it was.

A. It was, and by July 15th, it might have been $1,500,000 or $6,500,000. In other words, it is a going concern. There are these debits and credits to the cash account, so you can't say that it is static.

Q. But your amortization figure is predicated upon the use of $4,661,875 of working capital; is it not?

A. It is based upon a total of $63,775,839.

Q. Which includes $4,661,875 of working capital?

A. That is correct. And I say that that is absolutely necessary, because that net working capital is just as in- [fol. 6658] dispensable as bricks and mortar to a booster station or a pipe in the pipe line or gas in the reserve.

Q. Now, you claim that the company is entitled to earn a fair rate of return upon that amount of $4,661,875 of working capital and you have made such provision, have you not?

A. I say that they have to make a return on that basis in order to keep the wheels turning in this business and offer adequate service to the public and maintain their credit position, yes.

Q. Do you know Mr. Sperry, treasurer of Panhandle Eastern Pipe Line Company?

A. Yes.

Q. Have you ever discussed the subject of working capital with him?

A. No, I have not.

Q. You didn't ask him what he thought was the proper requirement for working capital for Panhandle Eastern Pipe Line Company, did you?

A. No; as I said originally, I took all of my figures directly from the published annual reports of the company with the exception of the June 30, 1941 statement which was published from an unaudited statement, because it was an interim statement.

Q. How much weight do you attach to Mr. Sperry's [fol. 6659] opinion on the subject of the amount of working capital required by this company?

A. I would attach considerable weight to it. After all, Mr. Sperry is an operating official and knows the ins and outs of the business.

Q. If I were to advise you that Mr. Sperry has testified in these proceedings that the proper amount of work-

ing capital for purposes of these proceedings is $1,519,000, would you be willing to reduce your amortization allowance, would you want to make a revision of your estimate?

Mr. Culton: Just a minute. We object to that question because it is not in accordance with the facts.

Mr. Littman: What is wrong with it?

Mr. Culton: Because he testified that that was the minimum, the absolute minimum and you used the word "proper." That is the difference.

Mr. Littman: Well, that is the amount that he testified should be allowed in this proceeding.

Mr. Culton: No; he testified that that was the absolute minimum. He did not say it was the proper amount. That is my only criticism of it.

Mr. Littman: Of course, the record will speak for itself. Of course, you would like to get 20 million if you could get it. But he said that that was the amount that they required for their purpose, and in my judgment, [fol. 6660] which, of course, is not testimony in this case, that is plenty high.

By Mr. Littman:

Q. By the way, your testimony also has the term "irreducible" in it, doesn't it?

A. That is right.

Q. Well, your irreducible minimum is what, for working capital?

A. I don't know what that is. I say this: that the $15,520,855 based on the present capital structure as shown in chart 37 is the irreducible amount of operating revenue that the company must have, or $15,459,545 based upon the refinancing of preferred stock as shown in chart No. 36 is the irreducible minimum that the company must have and in either event so far as the credit position of this company is concerned, it must have for current capital requirements an irreducible minimum of $5,064,821 on the present capital structure basis or $4,993,511 based upon refinancing of preferred stock, and I have not made any statement as to detailed items other than that, but I have said that those were irreducible minimums.

Q. Well, of course, your $2,541,034 shown on chart No. 37 for return of capital when gas reserves are exhausted, is one of your "irreducible minimums"; is it not?
[fol. 6661] A. That is the invested capital of the figure which has been mentioned, $63,775,839.

Q. And it includes 1/25 of the four million odd dollar figure of working capital which you have used for purposes of this proceeding, does it not?

A. That is correct.

* * * * * * * *

By Mr. Littman:

Q. Mr. Coffman, does Panhandle Eastern Pipe Line Company provide for any amortization of working capital on its books?

The Witness: May I have that question read?

(The pending question, as recorded above, was read by the reporter.)

A. I don't know whether it does or not, Mr. Littman, because, as I have said to you, I haven't examined the company's books, I am just taking the annual reports.

By Mr. Littman:

Q. Do you know of any natural gas company that provides on its books for the amortization of working capital?

A. Well, not directly, but I think in regard to the pro-
[fol. 6662] ceedings here it should be pointed out that, while I am talking of invested capital in terms of the various forms of securities outstanding and the surplus account, it so happens that a calculation of invested capital by the method of taking the net property and the net working capital and intangibles is about the same figure and that is the reason that I followed, in this particular case, the procedure that I did. If you will look at chart No. 10 in Exhibit 65, invested capital is there discussed as meaning net debt, preferred stock, common stock, and surplus. In 1940, in round figures, the amount was $59,400,000. On Chart No. 11, in Exhibit 65, we defined invested capital there as net property and net working capital, and intangibles which in 1940 was $59,900,000, so that it so happens in Panhandle Eastern Pipe Line Company that irrespective of how you define invested capital, you are

talking about the same sum of money, so that I think in answer to your immediate question about amortization of working capital, the answer I have already given in regard to the amortization as applied to the invested capital still holds good.

Q. My question was whether you knew of any natural gas company that made a provision on its books for the amortization of working capital. Now, what is your answer to that specific question?

A. None, directly.

[fol. 6663] Q. Do you know whether such a practice would be permitted by the Federal Power Commission under its uniform system of accounts?

A. I don't believe it would, that is directly on that particular item; no.

Q. Now, you stated at the last session that you had read a number of rate cases on subjects touching your study contained in Exhibit 65, did you not?

A. Yes, I did.

Q. Can you cite to me one rate case in which any rate making body or court has permitted the amortization by a natural gas company of its working capital?

A. Well, I say that in the Bluefield case, which is referred to in this study I have made, it states that: "The company is to be entitled to a return which will permit it to render and maintain a proper service to the consuming public, maintain its credit position, and have something above for a margin of safety.

No one of these cases or any other report that I have seen breaks the item down minutely to net working capital. They are all talking in terms of the invested capital or property that is necessary to produce this service and, also, the return that is necessary to have that property produce a service which will be adequate to serve the consuming public and, also, this return to maintain the credit [fol. 6664] position. In that connection must be taken net working capital because it is a part of the active invested capital used in the business.

Q. Well, I take it then that you can cite me no specific instance where any court specifically made any allowance in operating expenses for the amortization of working capital; is that correct?

A. Well, perhaps I interpret the language improperly, but in the Bluefield case, among other things, it says that "the return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate under efficient and economical management to maintain and support its credit position and enable it to raise the money necessary for the proper discharge of its public duties."

Well, so far as I am concerned, that is what they are talking about, among other things.

Q. Well, what you have just read to me defines return, does it not, which is equivalent to net operating revenue on an income statement? Is that correct?

A. Well, all the figures, as I have just discussed earlier this morning, that are included in the operating statement some place along the line are converted to cash and working capital. It is inevitable.

Q. Now, we are not talking about net operating rev- [fol. 6665] enue, we are speaking of operating revenue reductions among which is a provision which you make for amortization of working capital. Now, I am asking you whether you know of any Commission or Court that has ever allowed such an item in operating expenses of a natural gas utility?

A. Well, I think we are talking about different things, Mr. Littman. What I have been talking about right along is the invested capital in this business and a part of that is this net working capital, the sum total of all the capital that was put in has come through an issue of securities to the public. I first said that that working capital is not static but is used and being converted all the time, some to fixed form of capital, some to current capital, and some to things in any going business day in and day out and merely because they have cash today means nothing at all. They have to have some liquidity in order to operate the business and so far as I am concerned, that is absolutely as essential as to have the pipe line out here to deliver the gas.

Q. Now, will you answer my question, please, Mr. Coffman? I think it can be answered with a very simple yes or no.

Will you please read the question again?

(Last question read by the reporter.)

The Witness; I still stand by my answer. I think [fol. 6666] that as I interpret the language in the Bluefield case and what I have said is the only answer I can give you.

By Mr. Littman:

Q. Well, are you stating that in the Bluefield case which was a water case, that the Courts and Commisssion made an allowance for amortization of working capital?

A. I didn't say that. I quoted the Bluefield case and said that I interpreted the language to mean that they would allow for any such item where it was a part of invested capital.

Q. Well, that is the only case that you can cite on the subject?

A. No, that isn't true. I told you that I had looked at United States vs. West, Railway vs. West, and, also, the Solar Electric case, that those were the three that I had given the most attention to at the time of preparing this, and that I had read a summary of many other cases in the field. After all, I was not reading those cases from the standpoint that an attorney might read them, I was looking at them to see whether I could discover whether the Courts might have said some place along the line or enumerated the factors that should be credited in any such study. I thought I had found that and I think they are pretty well stated in the Bluefield case. That is the only reason I quoted it.

Q. Your understanding of the law is that net working [fol. 6667] capital should be amortized over the remaining life of the property. Is that your testimony?

A. No. I said that, as I have indicated, I think the invested capital in this case, net invested capital, should be amortized as I have defined, and, as a part of that, there was a net working capital item in the amount mentioned. In other words, I contended that if the invested capital in the business is so many dollars, then there must be an allowance for that to make or cover a return of the capital over the estimated life that has been made. Otherwise investors would not buy securities in this firm, therefore, the credit position could not be maintained so it could finance its new business.

Now, if you have working capital such that it can finance itself partly without going to the market, that is one way to do it, and it is one sound way to do it.

Q. Well, have you amortized in your calculation over the remaining 25 years the amount of four million odd dollars of working capital which you stated a few minutes ago?

A. I can't give you the specific amount, but it is included in the $63,000,000. There is a net working capital amount in the $63,775,839.

Q. Will you refer to your table for chart No. 14? In the eighth line of that table appears a sum of $4,661,875 [fol. 6668] which is labeled "Net Working Capital." Now, I am asking you whether or not your allowance of $2,551,-034 to return capital to investors when gas reserves are exhausted, includes the amortization of that amount of net working capital? Now, can you answer that question or not? It either does or it does not. It seems to me that a question like that should be answerable yes or no.

A. Well, my answer still stands that it includes a portion, but the base figure that we we were using was $63,-775,839. The reference that you make here is not directly to that figure. That is the reason I won't say yes or no.

Q. You cannot answer my question yes or no?

A. I say there is an allowance, but I won't say it was the $4,661,875. I do not have that specific dollar amount here.

Q. Well, would your allowance be very close to the $4,000,000 figure?

A. I think that would be true, yes.

Q. So that for all practical purposes, your amortization claim of $2,551,034 does contemplate the amortization of substantially the $4,661,875 of working capital?

A. Yes.

Q. Well, now, I take it, it is your estimony that that [fol. 6669] is an altogether necessary thing to be done?

A. You mean there as to both the amount and the method?

Q. I mean as to the necessity or need for amortizing that amount of working capital.

A. My contention is that that net working capital, as is shown in the statements from which I got the figures, so

long as it remains in the business it is necessarily a part of invested capital.

Now, if the management belied, in their opinion, that the working capital position was such that it was too large and could be reduced, there are several alternatives which they might have followed. They could have reduced the debt, paid a dividend or the like in each of which events the invested capital would have been reduced. Now, the fact that at the date we are talking about the management did not do such things but maintained this capital in the net working capital part of the company, I take it they believed as a matter of business policy that it was necessary. However, if the Commission or any other tribunal by its study should find that it was not necessary, then I would be willing to use such figure as might be determined, but that would have, still, no effect on the final item in my charts either No. 36 or No. 37, that is the amount that would be necessary, still, for this company [fol. 6670] to secure to maintain its credit position.

Q. In other words, you would stick by your final amount regardless of what the Commission would do with respect to cutting down this allowance of $4,661,000 for working capital; is that your testimony?

A. Well, to be sure that we are discussing exactly the same thing, you have referred here to chart No. 37 and I just want to be sure that we are talking about the same thing. I contend that the $5,064,821 which is captioned "Current Capital Requirements," regardless of whatever else the Commission may find about any of the preceding items included in Chart No. 37 will remain until conditions change. Now, if they change for the worse, it will be higher; if they change for the better, it will be lower. But so long as they remain the same, you can do whatever you please, as a Commission, with the preceding items, but I say the $5,064,821 is absolutely essential to maintain the credit position.

Q. And in the event the Commission were to reduce the three items shown in Chart No. 37 labeled "Operations and Maintenance," "Texas," and "Return of Capital when Gas Reserves are Exhausted," then the "Total

Dollars Needed," as shown by the extreme left-hand bar in your chart No. 37, would be corespondingly reduced; is that correct?

A. Yes. If a study made by the Commission should [fol. 6671] take any amount which I have used, based on annual report figures, and should prove to be improper, then, that necessarily would have a bearing upon the total amount.

Q. That is the gross revenue?

A. Gross revenue, but so far as the $5,064,821, captioned "Current Capital Requirements," is concerned, that will not be changed, because that figure was determined, not by what the company was doing, but by the capital markets. In other words, what was happening in the securities market.

Q. Yes. We are going to come to that figure a little later, Mr. Coffman, and we will have a rather full discussion of that item a little later. The thing that disturbs me somewhat is the fact that you label that Chart No. 37 "Dollars Needed Annually," and the total dollars to which you refer include these various items among which is the claim for amortization.

A. Yes.

Q. Now, that is why we are trying rather fully to develop these subjects.

Now, coming back to the subject of working capital, you understand that working capital is the amount of money which the company requires for the conduct of its business and for the purpose to which working capital will ordinarily apply, do you not?

[fol. 6672] A. Well, I understand working capital to be defined as the difference between the current liabilities and the current assets. That difference is called "Net working capital" and I say that net working capital is required to keep the wheels turning in any business. Now, the size of the working capital in the first instance is usually determined by management as they are going along and the Commission can review that and decide whether or not it is excessive or not large enough, but I, as I have said, relied upon the figures shown in the annual reports, took the figure as it was and said that that is a part of invested capital which was actually operating in the business.

[fol. 6673] Q. Now, is the definition of working capital which you gave a moment ago, to-wit, the difference between current assets and current liabilities, a proper definition, in your opinion, of working capital for rate-making purposes?

A. Why, I would say that is, was, generally.

Q. Now, in your opinion, this $4,661,000 of net working capital is necessary. Is that right?

A. I said that at the date of issuance of the statement there was that much shown. It is within the province of the management to determine as they are operating a business whether or not they need more or less.

They have several possibilities. If it is more, they can pay off debt or pay a dividend, in either of which cases they reduce invested capital. The fact that the money remained in the business and had not been so used, in my opinion, indicated that the management felt that it was necessary and if it can be proved otherwise, then, we will determine what the new figure is and use that figure, but for the moment I used the figure so shown for the reasons given.

Q. Now, assuming that the company actually needs and requires this amount of $4,661,000 for working capital in the conduct of its business and will require that amount throughout the life of the business, when the day arrives [fol. 6674] on which the company is going to wind up its business 25 years hence, according to your prediction, the company will still have this $4,661,000, will it not?

A. Well there, again, I make the same contention that I made earlier this morning, that this $4,000,000 is not like a gold bar in the basement of the Federal Reserve Building.

It is being turned around day in and day out, so that the $4,000,000 you have today has long since been buried in fixed assets and you may wind up with another $4,000,000 or something, but you have not had that $4,000,000 throughout all the time.

It has been in and out and is being used in the business.

Q. Yes. That is precisely the purpose of working capital, isn't it, to be used in a business?

A. Exactly.

Q. Well, I am assuming all of those things, Mr. Coffman, for purposes of my question but notwithstanding the use of this amount of $4,000,000 from time to time throughout the life of the business, when the day of death of the business arrives and the company is liquidated, the $4,661,000 will then be available and on hand for distribution, will it not?

A. Well, I certainly would not want to say that. I will give you this situation to define my answer: As this com- [fol. 6675] pany goes on, I can easily see questions of higher costs arising, more difficulties of securing gas and they get to a point where instead of showing a large profit there will be a smaller one.

It is easily conceivable to see where the company may not wind up with this given amount at all. A good many companies in Pennsylvania wound up some years ago, you know, leaving $6,000 and $7,000 or millions of dollars, taking them as a group, in bonds that were not paid off.

Q. Mr. Coffman, I am assuming that your advice is taken and that everything is going to go along very lovely right down to the last day and your advice is followed and down on the last day they have made adequate provisions for all the things that you have made.

Now, on that last day the $4,661,000 of working capital which was on hand on June 30, 1941, will still be on hand on the last day. Isn't that correct?

A. It will be then available if they have suffered no losses [of] if there is nothing else that has happened to wipe it out.

Q. All right. In addition to that you are going to have another $4,661,000 on hand because you have made an allowance for amortization of that amount over the remaining life of the property. Isn't that correct?

A. Well, it seems to me that that was included. If you [fol. 6676] agree, to begin with, that invested capital is entitled to a return and the $4,000,000 was a part of invested capital, I see no difference between a return on that, if it is actually needed to run the business, and the amount that you have exhausted in your reserves, your plant, your pipe line, and so on.

Q. Well, you are beginning to inject a third item. I thought that I could point out to you that under your method the investors will not only have their original investment in working capital of $4,661,000 on the last day of the life of the business, but will also have another $4,661,000 brought about by reason of your amortization allowance.

Now, what is this additional item that you are speaking about? Are you proposing that a third allowance be made?

A. Well, I do not know of that, if I did. I do not know where you got that impression.

Q. Well, do you think it fair for rate-making purposes that the investor be given a provision for the amortization of working ~~capital, so that~~ at the end of the life of the business he not only will have his original investment in working capital, but, also, another similar amount?

Does not that strike you as being a fallacious method?

A. Well, it seems to me, of course, under your question, if everything works like clockwork from beginning to [fol 6677] end and there were no hazards involved in the business at all, I could see it, but where there are hazards in the business it seems to me that there necessarily must be some net amount to provide for those contingencies and I do not think that that is unreasonable.

As a matter of fact, I do not know how a business could operate otherwise and a provision, therefore, will have to be made for it.

Q. Is there any depreciation suffered on working capital?

A. On cash working capital there is not, but all of this working capital that you are talking about, in the first place, is not cash and, in the second place, as the business goes on it is being invested in various forms of capital from fixed to semi-fixed which definitely have problems connected thereto, so I cannot say at the end of a certain amount of time that the amount will be one item or another.

Twenty-five years is a long time to be taking into consideration, obviously, and it is a long time for an investor to take a risk with his capital.

Q. But your theory presupposes that this entire $4,-661,000 working capital is going to be used up in the next 25 years, by reason of the exhaustion of the gas supply. Is that correct?

[fol. 6678] A. It is included, that portion of it is included in invested capital and by dividing the sum total by 25, in this particular case, at the end of the time you have presumed to recover or at least cover that investment.

Q. Well, are you expecting the entire amount of $4,-661,000 of working capital to have been consumed in the business at the end of the 25-year period?

A. Well, it may well be. I do not know what the actual working out will be in 25 years. I say, if you want to take it the other way around, you are operating a business to render a service to the public.

The pipe line and all the necessary equipment that goes with it, plus the reserves, standing alone, cannot render a service to anybody. It is just idle equipment.

Now, if to put that idle equipment to work it is necessary to have some working assets to make the business wheels go round, then it is just as essential in the business and the customer must allow for it as much as any other part of the business.

Q. Now, assuming, Mr. Coffman, that at the end of the life of this business, 25 years hence, the company has on hand its working capital of $4,661,000, which is the same amount which it had on hand, according to your [testimoney], on June 30, 1941, would you say that it would be proper to return to the investors an additional amount of [fol. 6679] $4,661,000 by the medium of amortization allowances?

A. Well, the purpose of the amortization is to cover the invested capital in the business. Now, if that is accomplished just to the dollar, all right. If there is any over, well then, that merely indicates, it seems to me, the vicissitudes of the business wherein you could not calculate to the penny and there are just as many chances, it seems to me, before you wind up the business that you won't have enough to go around as that you will have $4,000,000 something over.

You are always assuming, it seems to me, a wind-up of the business where we have all the $63,000,000 in the till so we tell everyone to come around and get their money.

I never knew any business yet that wound up that way. It has always been the other way, I come around and ask the people to take 50 cents on the dollar or 25 cents on the dollar or something else.

Q. Well, you are assuming that there is not going to be any money left in the working capital till at the end of the business unless provision for amortization is made. Is not that your assumption?

A. I think we are talking in circles, Mr. Littman. You are trying to say, as I understand it, that this is a 100 percent static proposition.

You can start today and 25 years hence you wind up, and [fol. 6680] I am saying that that cannot be considered in a going concern, so as you go on there are these hazards coming in, a higher charge to get gas and a number of other things, so that these factors have to be taken into consideration and they will be as the years go on.

Q. Will you answer my specific question, please? I think it can be answered yes or no. It deals with your method.

Will you read the question, please?

(Whereupon, the pending question was read by the reporter.)

The Witness: Yes, that is correct, that is correct.

By Mr. Littman:

Q. Now, if it should happen that there is money left in the working capital till at the end of the 25-year period, your allowance would be a duplication to that extent, would it not?

Now, can you answer that yes or no?

A. To the extent that there is money over and above?

Q. Yes. A. Yes, to that extent, there would be.

Q. You understand by "over and above", I meant to the extent that there is any money left in the working capital accounts.

A. Starting with zero, anything above the zero amount from where we started of the $63,775,000—

[fol. 6681] Q. (Interposing). Would be duplicated?

A. That is right.

Q. You are a certified public accountant?

A. No, I am not. I have taught accounting for a number of years and collaborated on several books.

Q. But you are, of course, an accountant?

A. I think I understand the subject fairly well.

Q. Do you think any certified public accounting firm would certify an income statement which showed amortization of working capital in a gas utility?

A. I do not think they would, as such.

Q. Under what circumstances, would they?

A. Well, it seems to me that, here again, we are confusing the issue. You are talking about, I presume, an annual report or some other statement to be made to the public which contains a certification.

I do not see any reason in such statement to make any such amortization that you are talking about; therefore, I do not think it would be in, but, on the other hand, if you were making a study such as we are here and certain factors have to be considered, why, you will take those factors into consideration.

After all, a certified public accountant at a given [fol. 6682] moment of time is merely saying there are $4,661,000 to the penny in the bank and they counted it and know it to be such. They are not saying any more.

Q. Have you ever seen an income statement, certified or otherwise, that included an allowance for amortization of working capital?

A. Well, there again, it is the amortizations that you see appearing in various certified statements that are usually for a particular asset.

Q. Can you answer that question yes or no, to your best recollection?

The Witness: Would you read that question again?

(Whereupon, the pending question was read by the reporter.)

The Witness: No, not directly.

By Mr. Littman:

Q. Now, you have testified that the amount of $4,661,875 of working capital, which you used for purposes of your study as of June 30, 1941, was obtained simply by deducting the current liabilities from the current assets shown in the company's balance sheet. Is that correct?

A. Yes, as shown on the table for Chart No. 14 there is shown there the working capital of current assets, less current liabilities to compute the net working capital of $4,661,875.

Q. Now, that amount is more than $1,000,000 in excess [fol. 6683] of the total "Operations and Maintenance" expense which you show in your Chart No. 37 for the entire year. Is that correct?

A. Yes, that is right.

Q. Are you recommending that this Commission find any such figure for working capital as $4,661,875?

A. Well, I think I have clearly indicated my position on that by stating the sources from which I took the material.

Now, if the Commission, by investigation, finds some other amount which is stated to be proper, why then I would think that that was the amount to use but I have given the source of my data and have predicated my results on it.

Q. Well, are you or are you not, as an expert, recommending that amount of $4,661,875?

A. Well, I am recommending two things, I am recommending the method No. 1 and the amounts, No. 2, unless the Commission can find that the amounts are in error, in which case I still say that my method can be applied and I will take the corrected figure.

Q. You are standing by the $4,661,875, are you?

A. Yes, for the purposes of this study it is the only figure I have.

Q. And for purposes of rate making, is it good?

A. For the purposes of the results that I show in [fol. 6684] this study.

Mr. Wheat: Mr. Littman, when you say "rate making", do you mean for purposes of fixing a rate base or some other base?

Mr. Littman: Suppose I ask the witness that very question.

By Mr. Littman:

Q. Would you say that this amount of $4,661,875 of working capital would be a proper amount to include in a rate base for rate-making purposes?

A. In so far as it is actually included in the amount of invested capital, I say "yes".

Q. All right. Now, will you please turn to your table for Chart No. 11.

Now, you show the amount of net working capital for each of the years, 1934 through 1940, on this chart, do you not? A. Yes, I do.

Q. Those are the figures which appear about the center of the chart?

A. Well, yes, on the line captioned, "Net Working Capital".

Q. Yes. Now, in 1936, as shown by this table for Chart No. 11 of Exhibit 65, the net working capital is $413,082. Is that right?

[fol. 6685] A. That is correct.

Q. Now, will you please explain why, in your opinion, the company should have more than ten times that much working capital in 1941 as it had in 1936?

A. Well, I think the table helps support the answer to that.

In 1934 they had a deficit in working capital of $74,837 and in 1935 they had a deficit of $376,327. In 1937 they had a deficit of $1,394,366.

Now, that merely proves the contention that I have been trying to make, namely, that conditions vary from time to time and at a given moment there may be a certain amount of working capital.

There may be at another time a deficit in working capital and in order to continue to operate this business successfully you must have a net working capital balance.

Now, in 1937 I presume that part of that drain at the moment was in connection with something to do with the Detroit operations. If I recall correctly, that was the first

year in which they began to render full service to the City and it probably required quite a bit of current capital.

Meanwhile, of course, the company has enlarged. It really has become a full-fledged pipe-line company. In 1936, the year in which you are talking about, if my recol- [fol. 6686] lection is correct, was before they really were servicing the City of Detroit, at which time, as we know, the size of the business jumped considerably, so I do not quite see that the comparison of the figure for 1936 with the one for 1940 necessarily would prove anything.

Q. Well, suppose we compare the figure of 1940, $2,205,097.

A. That is right.

Q. Will you tell me why it is necessary to have twice as much working capital six months later?

A. Well, I should suppose, Mr. Littman, that it would be a fair answer to say that there is just as much reason, I should think, for the possibilities of that in view of the negotiations that are now on for Michigan Gas Transmission, which will further elaborate this company, as there would be to show that for 1936, let us say, that it was twice as great as 1935.

Mr. Littman: Will you please read back that answer?

(Whereupon, the last answer was read by the reporter.)

By Mr. Littman:

Q. You expect part of this working capital to be used for the purpose of purchasing Michigan Gas Transmission Company?

A. No, not necessarily, but I would assume that if the Michigan Gas Transmission Company is acquired and con- [fol. 6687] solidated with the Panhandle Eastern Company naturally the consolidated situation is going to be much larger in total dollars and in volume of business and I should suppose, therefore, that it would require more ~~net~~ working capital.

Q. But you do not know?

A. I don't know what the amount will be, but that just seems to me to be good business judgment to expect that.

Q. As a matter of fact, you did not make any study to ascertain what amounts of working capital were actually

required by Panhandle Eastern Pipe Line Company for the next year?

A. No, that is correct, I took the figure as it was stated.

Q. Now, according to your method, if you had made this study as of the end of the year 1937, in which year the company had a negative working capital figure of $1,394,366, you would have found that negative amount as the required amount of working capital in that year?

A. No, because I am not talking in terms of working capital here at all, I am still talking in terms of total invested capital and the only way that I know that invested capital can be changed is in case you suffer an actual earnings loss or in case you pay off some of the capital, so I still, when I talk about the over-all picture, want to talk about the invested capital as a whole and not about a par-
[fol. 6688] ticular item that you may be referring to.

Q. But if you had used invested capital as you used it for purposes of this study, then in 1937 your invested capital amount would have reflected a negative net working capital of $1,394,366. Isn't that correct?

A. And if such item could have been—

Q. (Interposing) Did you say "yes"? I thought you nodded your head.

A. No, I said if in that year that amount of deficit in working capital you are talking about had meant a deduction in or a reduction in the total invested capital, I should have taken the invested capital for the amount as stated, which was $55,477,864 and that is the figure that I am using throughout.

It is the item appearing in the line captioned "Total Invested Capital for 1937".

Q. And that $55,477,864 reflects the net working capital figure in the negative amount of $1,394,366, does it not?

A. It reflects it and it would merely mean to me that if you found a situation like that carrying over a period of time, the company would then have to consider some additional financing to bolster its position, in which case invested capital would then go up.

[fol. 6689] By Mr. Littman:

Q. Mr. Coffman, I have prepared for purposes of simplifying and facilitating this cross-examination a very simple balance sheet, a copy of which I hand you.

Now, Mr. Coffman, this balance sheet which I have just handed you shows, on the asset side property of $33,000,000 and cash and Government bonds, $30,000,000, total assets of $63,000,000.

On the liability side, it shows invested capital of $63,000,000, a total of invested capital of $63,000,000.

Now, I am going to ask you to assume that this is the balance sheet of a natural-gas pipe-line utility as of June 30, 1940, and that there is a remaining life of gas reserves of that company as of that date of 25 years.

Assuming these conditions and assuming the accuracy of this balance sheet, under your method you would divide the 25 years into the total invested capital of $63,000,000 in [fol. 6690] order to obtain the annual provision for depreciation, depletion and amortization, is that correct?

A. Looking at it from the standpoint of the investor, that is correct.

Q. And that is the method you have followed, is that correct, namely, dividing the total invested capital by the remaining years of life?

A. That is the method I have used.

Q. I now hand you another balance sheet shown on a single sheet of paper purely for the purpose of facilitating this cross-examination.

This balance sheet is for the same company and is as of June 30, 1941, and this balance sheet shows, on the asset side, property of $33,000,000 and cash and Government bonds of $32,520,000, total assets of $65,520,000.

It shows on the liability side that reserves for depreciation, depletion and amortization are $2,520,000 and the invested capital is $63,000,000, making total liabilities of $65,520,000.

I want you to assume, Mr. Coffman, that conditions during the year ended June 30, 1941, have remained static with respect to capital additions.

A. You mean June 30, 1942?

Q. 1941. You see, my first balance sheet is as of June 30, 1940.

[fol. 6691] A. I see.

Q. I want you to assume that conditions remain static in so far as the property account is concerned and I want you to assume the conditions which I have just stated and I will ask you whether or not this balance sheet would correctly reflect those conditions as of June 30, 1941?

A. Well, with one exception, Mr. Littman, that obviously, from your balance sheet dated June 30, 1941, the company must have earned in the interval June 30, 1940—June 30, 1941, the sum of $2,520,000.

Every other condition remained static.

Q. Why do you say that the company must have earned $2,520,000?

A. Well, you have reserves here for $2,520,000, all of which you have assumed went to cash and stayed in cash and there is only one place that it could possibly have come from unless they sold more securities and your capital indicates they did not, so the only possible place it could have come from was earnings.

Otherwise, you would have had $63,000,000.

Q. Would not this balance sheet as of June 30, 1941, obtain if the company had not earned any money?

A. No, it could not possibly have obtained. It would be impossible. If it had not earned any money, you would have had $33,000,000 of property offset by $2,520,000 in [fol. 6692] reserves and your cash would have been $30,000,000.

Q. Assuming that the total operating revenue was $10,000,000 for purposes of illustration and assuming that the operating expenses together with the amortization allowance was $10,000,000 leaving a net operating income of zero, would not this balance sheet as of June 30, 1941, properly reflect the situation as of that date?

A. No, because there had been no way you could have increased the cash $2,520,000.

In other words, your assumption is that they received $10,000,000 in and they spent $10,000,000 out, so how could you have increased the cash $2,520,000?

Q. No, the illustration which I just gave assumed that they took $10,000,000 by way of gross revenue.

A. Yes.

Q. And that they paid out in cash, operating expenses of $7,500,000 and that they retained $2,520,000 for amortization, depletion and depreciation.

Wouldn't this balance sheet properly reflect the situation as of 6-30-41?

In other words, you would, under those conditions, have an increase in your assets of $2,520,000, is that correct, offset by a corresponding amount in the reserves?

A. I think some of those figures you have given me do not check, do they? If you had taken in $10,000,000 and [fol. 6693] you spent out $7,750,000—

Q. (Interposing) The operating expenses should be $7,480,000 to be exact. Those are cash operating expenses.

A. That would indicate that $2,520,000 of fixed property had been converted to cash so that now your property account would net stand at $31,480,000 and your cash would show $32,520,000, merely a conversion of a fixed asset to a current asset.

Q. Would that be true under the assumption that the company had operating revenues of $10,000,000 and cash operating expenses of $7,480,000 and had charged $2,520,000 to its reserves for depreciation, depletion and amortization, leaving a net operating income of zero?

A. I do not see how it could be otherwise. I mean, your own balance sheet shows it.

Q. You say this second balance sheet that I have handed you is incorrect and does not properly reflect the situation existing as of June 30, 1941?

A. The balance sheet as you show it, taking out a reserve of $2,520,000 correctly represents the situation as it stands at the present time.

Q. And that same situation would obtain as shown on this second balance sheet as of June 30, 1941, even if the company did earn some net operating income provided it paid that net operating income out in dividends before [fol. 6694] the end of the year, isn't that correct?

The Witness: I will answer "yes", with this further explanation to be sure we are talking about the same thing.

If the company earned any amount over and above the allowance for depreciation which you took and such amount, whatever it may have been, was to the dollar distributed, then this balance sheet still correctly reflects the condition.

By Mr. Littman:

Q. Yes.

Now, will you point out for us, by reference to this second balance sheet which speaks as of June 30, 1941, where, under your method, is any credit whatever given to the rate payers for the $2,520,000 paid during the year for depreciation, depletion and amortization and charged to those reserves?

A. Well, under this hypothetical balance sheet dated June 30, 1941, which you have presented, looking at it from the investor's point of view, there was set aside, representing exhaustion of an asset, $2,520,000, which, for all practical purposes, was conversion of a fixed asset to a current asset as fully represented in your item captioned, [fol. 6695] "Cash and Government Bonds."

However, so far as the investors were concerned, they had no return of that whatsoever so it is still invested in the business so that, at the present time, there is invested in the business the $63,000,000 plus $2,520,000 or a total of $65,520,000 which represents their total invested capital and until you would use a portion of the $2,520,000 to distribute to the investors, that cash is actually working and invested in the business and they would expect, naturally, leaving that cash in the business rather than taking it out, to be compensated for the use of that money.

Q. And under your method you would continue to reflect in the current rates charged to the rate payers a full return on the total invested capital, would you not?

A. I say to maintain the credit position of this company, if the investor leaves his money so that it is working in the business or at least, to put it the other way around, he does not get it to use personally himself, it is

just the same working there as it would if he received it and placed it elsewhere to work.

He wishes to have a return and whenever any company is privately financed and does not so return a fair amount on capital, you no longer maintain the credit position of this company. You no longer can finance by private means.

[fol. 6696] Q So that your answer to my question specifically is "yes", with the explanation you have given?

A. Exactly, yes, sir.

Q. Now, your answer remains the same notwithstanding the fact that this balance sheet as of June 30, 1941, clearly shows that the company has $32,520,000 of cash and Government bonds on hand?

A. Well, of course, I think that assumption is fallacious and unreasonable but, taking it as an assumption, if the management retains the sum total of that cash and Government bonds in the business which, after all, belonged to the original investors who put the money in, they naturally will expect a return.

Now, if the management should feel or the Commission should feel or the security holders should feel that the amounts of cash and Government bonds being retained is not warranted and is an unreasonable amount, then they have the option, that is, the management, of distributing a portion or all of the cash and Government bonds to the security holders in which case, they have been paid off their capital; the invested capital of this company is less and we go to the new base but, so long as the security holders do not have any return of that invested capital and it is still working in the business, it handicaps him or deprives him of using his capital elsewhere where he could make a [fol. 6697] return and he demands a return upon it.

Q. Now, is it also your testimony that under your method no credit whatever is given to the rate payer for the $2,520,000 paid during that year for depreciation, amortization and depletion under the assumptions comprehended by these two balance sheets, is that correct?

A. So long as those items are not used to distribute to the security holders, yes.

Q. You realize, do you not, that we are undertaking to illustrate the straight line method of depreciation?

A. Well, I was not aware of that but I think what I have said to date would still answer.

Q. Your answers would still hold?

A. I think so.

Q. Do these balance sheets show a correct application of the straight line method of depreciation as you have used it?

A. In so far as you have assumed $63,000,000 of invested capital at the outset and have assumed 25 years of life, the $2,520,000 is one-twenty-fifth which is the first year's operation that we are assuming under that and if that method were followed with the same amount each year on that amount of invested capital, it does.

Q. I wanted you to state whether or not these illustrations which we have just gone through as evidenced by [fol. 6698] these two balance sheets is, in your opinion, a correct application of the straight line method of depreciation?

A. It is, based upon the assumption that there is no salvage value to be left at the end of time.

Q. You understand, Mr. Coffman, that by my questions I am not intimating that Commission counsel agrees necessarily that these balance sheets and the methods that you have described are a proper application of the straight line method of depreciation? I do not want you to understand that I am necessarily agreeing with this.

A. No, I understand but I still stick with my answer that, so far as accounting procedure is concerned, if you assume no salvage at the end of time and when I say "end of time", that is currently used in accounting terminology to mean the length of time estimated for these properties, this represents the straight line method.

Q. Have you made any investigation, Mr. Coffman, to ascertain whether this method of yours of determining the amount to be set aside annually for depreciation, depletion and amortization is in accordance with the Commission's Uniform System of Accounts?

A. No, I have not made that investigation. I am talking purely from the technical accounting point of view.

Q. And not having made the investigation, you are not prepared to say that your method is in accordance with [fol. 6699] the Commission's Uniform System of Accounts?

A. No, I am not prepared to say whether it is or not.

Q. Is your method in accordance with any accepted method of determination of amortization allowances as evidenced by certified statements?

A. Well, I do not know just what you are driving at there. After all, the subject of depreciation and amortization is a complicated one.

I say this, that in any particular piece of property where engineers can estimate the reasonable life of the property, that it is customary, in many instances, to take out an equal annual allowance until the orginal investment in that property is covered where you assume that there is no estimatable allowance for salvage at the date you originally considered the first investment.

Q. Now, you have testified heretofore that you placed great reliance upon certified statements of various corporations, is that correct?

A. That is correct.

Q. Now, would you give us the name of a natural gas utility whose statement you have examined, as certified, which utilizes this method of determining the amounts to be set aside annually for depreciation, depletion and amortization?

A. I do not believe that you could find any statement, [fol. 6700] Mr. Littman, which would tell you the method that was used. As a matter of fact, it will tell you that, in the depreciation and depletion was a certain amount.

In some of the registration statements where they define completely their depreciation policy, it may state it but it would not state it in most annual reports as certified, because it is not a common practice.

They merely tell you they have reviewed the books and the depreciation and depletion reserve allowances were in accordance with company practices and the amounts set aside were proper in their opinion.

Q. Can you cite us one natural gas utility that actually uses your method of determining the amounts to be set

aside annually for depreciation, depletion and amortization?

A. I do not believe I could at this time, no. I would have to review the various companies and discover that.

Q. Now, do you know whether Panhandle Eastern Pipe Line Company uses this method of yours in making its determination of the allowances for depreciation, depletion and amortization annually?

A. No, I do not know that because I did not refer to the books and in the annual reports, as I recall it, there was no statement except certain amounts were set aside.

Methods were not described.

[fol. 6701] Q. Do I correctly understand your testimony to be that the only time you deduct a reserve for depreciation, depletion and amortization to establish a base for rate making purposes is when the equivalent amount of the reserve has been paid out as a liquidating dividend?

The Witness: Would you please read that?

(Whereupon, the pending question was read by the reporter.)

The Witness: Mr. Littman, that question is confusing to me for this reason: I have tried to make it clear that in my approach I have been attempting to determine the dollars necessary to keep this business operating in an efficient manner from both the standpoint of the consuming public and the investing public, that is, maintaining the credit.

When you refer to the rate-making base, it confuses me because I do not quite tie that in. I mean, I am not talking the classical theory and when you say, "for rate-making purposes", I think you are.

I would like to be clear on that one point throughout. When I have been talking here, I have not been trying to distinguish between the classical theory and my own approach.

I have been talking about my approach altogether.

By Mr. Littman:

Q. Well, under your approach, it is correct to say that the only time you give any credit to the depreciation, depletion and amortization reserve is when the equivalent amount of that reserve has been paid out as a liquidating dividend?

[fol. 6702] A. Yes, I would say that is generally true, that until the cash has actually been paid out to the investor, it is still maintained in the business as a part of invested capital and the investor says, "If you want more capital from me, you must continue to maintain the credit and give me a return thereon."

Q. And that is your understanding of the correct application of the straight line method of depreciation?

A. I do not know as that has anything to do with the straight line method. You could call it a sinking fund method.

There are various methods of depreciation. There is one where you take out the identical amount each year. There is another where you say the assets are exhaustible and in the early years, you take out more and in the later years you take out less.

In other forms of business it is the reverse. You take out smaller amounts in the earlier years and more in the later years, so I do not see there is any connection between what I have just said between the straight line method or any other method.

Q. Did you investigate to ascertain the amount in the reserves of Panhandle Eastern Pipe Line Company for depreciation, depletion and amortization as of June 30, 1941?

[fol. 6703] The Witness: May I have that read, please?

(Whereupon, the pending question was read by the reporter.)

The Witness: You are talking about the reserve for depreciation and so on. Yes, I was aware of that. It was in the balance sheet and the figures are shown here in my report, if you are talking about the dollar amount.

By Mr. Littman:

Q. Yes.

A. If you are talking about the number of M.c.f.'s, no, but if you are talking about the dollars, yes.

Q. The latter is correct. I am not now speaking of gas reserves.

A. Yes, that is right.

Q. You are aware of the fact, are you not, that as of that date the reserves for depreciation, depletion and amortization and of gas sales and purchase contracts totaled $11,747,170 as of June 30, 1941, is that correct?

Would it be more helpful if I handed you the balance sheet?

A. I have one here. I was seeing if I had it in a table so I could refer specifically to it.

Mr. Wheat: On the table for Chart No. 14 there is an item of retirement, renewal, depreciation and amortization reserves of some $10,000,000-odd.

Mr. Littman: Is that $10,135,000?

[fol. 6704] The Witness: Yes, that is it.

Mr. Wheat: Yes, $10,135,514.

Mr. Littman: Yes.

By Mr. Littman:

Q. Do you find that, Mr. Coffman?

A. Yes, I have that now.

Q. I will tell you how I got the additional amount in just a minute.

Now, that $10,135,513 is made up of reserves for depreciation of gas plant in an amount of $9,345,403; reserve for amortization and depletion of producing natural gas land and land rights of $403,389 and reserve for abandoned leases in the amount of $386,721, making a total for those three reserves of $10,135,513.

Do you find those figures, Mr. Coffman, as of June 30, 1941?

A. I do not have the sum of the individual items that you mentioned at the moment, but I do have the $10,135,

514—the figure you mentioned is $10,135,513, but there is 92 cents so we call it $10,135,514.

Mr. Culton: Was that the aggregate that you originally used?

Mr. Littman: No, I am now going to explain how I got the other amount.

By Mr. Littman:
[fol. 6705] Q. Those three items, I might state for the purpose of the record, were taken by me from Exhibit 48, Page 2, which is the balance sheet offered in these proceedings by Mr. Watkins and are shown from Lines 28 through 33 of that page.

Mr. Wheat: In column—

Mr. Littman: (Interposing) In Column M as of June 30, 1941.

By Mr. Littman:
Q. Now, that $10,135,514 jibes, does it not, with the one in your Exhibit 65?
A. Yes, it does.
Q. Now, to that I have added an item which appears in Exhibit 52, Page 2, Line 42, called, "Reserve for Amortization of Gas Sales and Purchase Contracts" in the amount stated as of June 30, 1941, of $1,611,657.

I hand you Exhibit 52, Mr. Coffman, so that you may see the item as it is set forth. A. Yes.

Q. And adding that figure of $1,611,657 to the amounts heretofore stated produces the total reserves as of June 30, 1941, of $11,747,170, is that correct, Mr. Coffman?
A. I did not get some of the detailed figures you read off but if they add up to that, I agree to the total.
Q. Well, at any rate, you have ignored these reserves [fol. 6706] in calculating your so-called "Dollars needed annually by Panhandle to return capital to investors when gas reserves are exhausted", have you not?
A. Yes, the total figure that I used as shown in the table for Chart No. 14 in Exhibit 65 was $10,135,514 which is the amount taken from the condensed consolidated balance sheet as at June 30, 1941, of Panhandle Eastern Pipe Line Company.

Q. My question is, have you ignored these reserves in calculating your so-called "dollars needed annually by Panhandle to return capital to investors when gas reserves are exhausted"?

I am now speaking of the reserves for depreciation, amortization and depletion accumulated by Panhandle Eastern as of June 30, 1941?

A. You cannot say that exactly, Mr. Littman, for this reason:

You will find in my exhibit, for example, on the table for Chart No. 10 where I have been trying to look at this thing from both angles, namely, the property on the one hand and the net working capital intangibles on the other hand, looking at it purely from the capital structure standpoint, you will see in table for Chart No. 10 where I have listed there the details of the capital structure for the individual years which, in all the cases, is a figure [fol. 6707] very closely approximating a calculation if you work out invested capital on the net property plus the net working capital figure and it was that invested capital figure that I used and when you pin me down to individual items, that is difficult for me to say because I talked in terms of the total invested capital as one lump sum and as represented by the securities outstanding in the hands of the public.

Q. Let us put it this way:

In calculating your so-called "dollars needed annually by Panhandle to return capital to investors when gas reserves are exhausted", you made no deduction of Panhandle Eastern's reserves for depletion, depreciation and amortization accumulated on its books to June 30, 1941?

A. I think we have. Your figure, I believe, if you work back and I am talking now from this statement captioned, "Condensed consolidated balance sheet as at June 30, 1941", there is an item captioned, "Less reserve for amortization of gas sales and purchase contracts—$1,611,657.30 which was and is subtracted from a caption, "Intangibles representing gas sales and purchase contracts" and so forth of $3,475,221.97, leaving an amount net of $1,-

863,564.67, which is the amount that is shown in table to Chart No. 14 which is—

Mr. Wheat: (Interposing) Of Exhibit 65?

[fol. 6708] The Witness: Of Exhibit 65, which is added in to get the total invested capital which I am talking about. I believe that is the identical figure that you are talking about.

By Mr. Littman:

Q. Now, excluding from consideration the reserve for amortization of gas sales and purchase contracts and speaking now only of the $10,135,513 accumulated in Panhandle Eastern's reserves for depreciation, depletion and amortization, I am asking you whether or not it is a fact that you made no deduction of those reserves in calculating your so-called "Dollars needed annually by Panhandle to return capital to investors when gas reserves are exhausted"?

A. I think I did take them out by the amount I have just read to you.

In other words, you see what I did, in table to Chart No. 14, I hoped to segregate first, the $10,135,514 which relates to retirement, renewal, depreciation and amortization reserves.

Then later on down in the tabulation, I took the intangibles net which automatically, of course, excludes the reserve of $1,611,657.

Now, I could have done the same thing in that table as I did up above. In other words, I could have shown intangibles at $3,475,221.97.

[fol. 6709] I could have substracted the $1,611,657 to show the $1,863,564. Instead, I just showed the figure net.

Q. I just asked you to exclude from consideration this reserve for amortization of gas sales and purchase contracts of $1,611,657. A. Yes.

Q. And I asked you to discuss with me for a moment purely the $10,135,513 balance in the reserve for depreciation, depletion and amortization as of June 30, 1941.

A. Yes.

Q. Now, we are talking about the $10,000,000 figure, aren't we? A. All right.

Q. Now, I am asking you whether or not it is a fact that you ignored those reserves totaling $10,135,513 in calculating your so-called "Dollars needed annually by Panhandle to return capital to investors when gas reserves are exhausted"?

A. Whether I ignored it?

Q. Yes.

A. No, I do not think I ignored it because I had to get the total invested capital I am showing by deducting it.

Q. Well, is the invested capital figure that you used for purposes of determining the amortization allowance shown anywhere on table for Chart No. 14 in Exhibit 65?

[fol. 6710] A. Not specifically in that amount but the method whereby I arrived at the amount is very definitely shown there.

Q. Well, the method whereby you arrived at your total invested capital was simply this, to add the total amount of the outstanding bonds, preferred stock, common stock and surplus, is that correct?

A. That is correct.

Q. And that came to $63,000,000-odd, did it not?

A. That is correct. On the invested capital as shown on June 30, looking at Chart No. 26, that was $63,525,839.

Q. Yes, and you simply divided that by 25 years to get your annual allowance for depreciation, depletion and amortization?

A. That is correct, but I just want to be clear when you say I ignored looking at something, I have demonstrated I am aware that I took them into consideration.

For this particular calculation, I based it on one-twenty fifth of $63,525,839 on the assumption I just mentioned; on this particular assumption.

Q. Now Mr. Coffman, I will ask you to turn to your table for Chart No. 14 of Exhibit 65 and I will ask you this question:

If this Commission were to use the property as the [fol. 6711] amortization base, what figure on this chart should be divided by 25 if that is the correct remaining number of years of life?

A. That figure is shown in Chart No. 14 computing invested capital on the basis of net property and net working capital intangibles of $61,216,031.

Q. Now, your figure of $61,216,031 which you just read includes $4,661,875 of working capital, does it not, Mr. Coffman? A. Yes, that is correct.

Q. Now, assuming that the Commission were to adopt Mr. Sperry's estimate of working capital in the amount of $1,500,000, what would be the total invested capital indicated on that basis?

Mr. Wheat: May I ask, Mr. Littman, are you making that assumption in connection with the development of a rate base, that that is the amount to be allowed for working capital?

Mr. Littman: I am asking this witness to state what the company's net investment is in the property plus Mr. Sperry's working capital. That is what I wanted him—

Mr. Wheat: (Interposing) If his balance sheet had shown that instead of some other item?

Mr. Littman: That is right.

The Witness: The invested capital as of June 30, 1941, [fol. 6712] would have totaled $58,054,156 if it had been tabulated on the basis of net property, $54,690,591; net working capital, $1,500,000; and net intangibles of $1,863,565.

By Mr. Littman:

Q. Now, in order that we all may follow this testimony, I am going to ask that you refer to the Chart No. 14 of Exhibit 65. A. Yes.

Q. Now, there you show the net property to be $54,690,591? A. Yes, sir.

Q. Then you show the net working capital of $4,461,875 and then you show intangibles which includes gas sales and purchase contracts in the sum of $1,863,565. Is that correct? A. Yes, sir.

Q. A total invested capital as of June 30, 1941, based on net property accounts, intangibles and working capital of $61,216,031. Is that right? That is what your chart shows?

A. Yes, that is what the chart shows. That is correct.

Q. Now, Mr. Coffman, am I correct in understanding that all of this amount of $61,216,031, except the net working capital of $4,661,875, represents every dollar that the [fol. 6713] investors have invested, according to the books of the company, in the property of Panhandle Eastern Pipe Line Company as of June 30, 1941? Isn't that correct? I am not speaking of dollars, I am speaking of the amount invested in properties, both in fixed capital and intangibles. A. As shown on the books.

Q. Yes.

I thought there was a pending question—

A. (Interposing) No, I thought I had answered the question.

Mr. Littman: Will you read the answer?

(Whereupon, the answer indicated was read by the reporter.)

By Mr. Littman:

Q. The answer is "yes", as shown on the books?

A. That is right.

Q. And that amount, by pure arithmetic, is $56,554,156, is it not? I would like to make certain of this figure.

A. What is the component parts of this figure you are giving me?

Q. I am taking your total of invested capital shown on your Chart No. 14 of Exhibit 65 of $61,216,031 and I am deducting $4,661,875 of net working capital. A. Yes.

Q. And I get the amount of $56,554,156.

[fol. 6714] A. That is correct.

Q. Now, this amount of $56,554,156 represents all of the money that the investors have invested as of June 30, 1941, in the fixed property of Panhandle Eastern, is that right?

A. Looking at it from the asset side of the balance sheet, that is true, but I also look at it from the liability side of the balance sheet, so you also have to refer to my table which shows the amount of the various securities outstanding plus the surplus accounts.

Q. Well, Mr. Coffman, here is what I am trying to get and I think we will have no difficulty in agreeing:

If every dollar invested in the plant and property of Panhandle Eastern, as shown on its books, is found to

have been actually and legitimately invested in property used and useful in the public service, then this amount of $56,554,156 would correctly represent the actual cost, the actual original cost of the property as of June 30, 1941, would it not?

Mr. Culton: You do not mean that question. You do not mean original actual cost. You mean depreciated original actual cost, don't you?

The Witness; It is the net value of the property as of the date stated.

By Mr. Littman:

[fol. 6715] Q. Less depreciation reserves?

A. Yes, or the net value of the property as of this date.

Q. It would represent the net investment in the property as of June 30, 1941, is that right? A. That is right.

Q. Now, notwithstanding the fact that the $56,554,156 represents the net investment in the plant and property of Panhandle Eastern as shown on its books as of June 30, 1941, you are undertaking to amortize not that amount but you are undertaking to amortize something in excess of $63,000,000, are you not?

A. I am, on my calculation, amortizing the amount of $63,775,839 as shown in Chart No. 27, Exhibit No. 65.

Q. Now, will you state why, under any theory, this Commission should allow to be amortized any sum in excess of the net investment in the plant and property of Panhandle Eastern as of June 30, 1941, which was, as you have stated, $56,554,156?

A. Well, I thought I had explained that a couple of times, Mr. Littman, on this [bases]:

It is my opinion that if this company continues as a going concern and depreciates and amortizes its properties but such sums forthcoming from such bookkeeping transactions are retained in the business to keep it going [fol. 6716] and are, therefore, reinvested in some form of asset except that portion that remains in cash that, so far as the investors are concerned, their money is still working in this business and to maintain the credit position of this company, they must be allowed some return for that use of capital.

Now, whenever it comes to a point that this company ceases to grow, ceases to need any additional amounts of capital so that even your own hypothetical balance sheet tends to be true, namely, the only operation is one of converting fixed assets to cash and the management thereupon pays out such cash or current assets in the form of liquidating dividends, the invested capital will begin to come down.

There is no reason for the maintenance of the credit position any more because there is no need for new financing and you will get the result.

Q. Will you point out what property over and above the $56,554,156 is used and useful in the public service?

A. Well, as I said this morning, I can take your very figure here of $56,554,156 which allows you net property which is fixed plant and allows you intangibles which is also, for the most part, fixed plant or semi-fixed plant and I will ask you how the business can be operated by the management with no cash or working capital.

Q. All right. Let's add to that amount the $1,500,000 [fol. 6717] suggested by Mr. Sperry.

Now, will you point to any property other than which is represented by Mr. Sperry's $1,500,000 of working capital and this $56,554,156 which is the net investment in plant, will you point out anything that is used and useful in the public service that is not represented by those two amounts which I just read?

A. Well, I do not know as I can point it out directly but I can make this observation, that so far as I understand what you have said about Mr. Sperry, Mr. Sperry, I believe, must have been talking about a different thing than I am talking about.

He apparently was talking about a rate base. I, on the other hand, am looking at what the management needs to maintain the credit position and I continue to say and maintain that if the management retains the $4,661,875 in the business rather than distribute it to the people who put in the original capital, it is still invested capital from their standpoint and they will require a return on it or,

if you refuse to allow them one, they will refuse to finance this property any longer.

Q. Let us exclude, then, this item which seems to be disturbing you, of working capital. Let's put that aside and let's confine ourselves to physical and tangible property, per se.

[fol. 6718] A. Yes.

Q. Will you tell me what property is used and useful in the public service, both tangible and intangible, belonging to Panhandle Eastern Pipe Line Company which is not represented by the net investment of $56,554,156?

A. Mr. Littman, I would have to say if you take the extreme example, as I believe this is, you are taking away from the management all of the current assets, net current assets.

Q. I am talking about a natural-gas plant—

A. (Interposing) You are taking away everything but the plant, fixed property.

Q. I am talking about the fixed property.

A. Then I ask you how does the management continue to operate one hour after you have done it?

Q. All right. I will ask you to assume, then, the correctness of Mr. Sperry's figure, just assume it, assume he is right.

Assume his $1,500,000 of working capital is a correct estimate and is all that is needed.

A. All right.

Q. And I want you to state what ~~more is~~ this company entitled to have by way of a return than a return upon its net investment in physical and intangible property represented by the $56,554,156 plus the $1,500,000 working cap-[fol. 6719] ital of Mr. Sperry's?

A. I think the answer to that is simple, Mr. Littman. If the Commission says and determines, after thorough study, that $1,500,000 is absolutely all that is needed and the management thereupon agrees or abides by that decision, whether they agree or not, then the first step, No. 1, to take is to take the $3,000,000 which is the difference between the $4,600,000 and the $1,500,000 and immediately distribute it to the security holders so it will be taken

out of invested capital and put in their hands to do with as they please.

Now, if the management, in spite of the decision on the part of the Commission would say, "Of course, we will have to abide by the decision and talk in terms of \$1,500,000 but, as a matter of business policy, we still say to run this business for public service and maintain credit, we must have \$3,600,000", I, as an analyst, would have to make that deduction; but, so far as I am concerned, the logical move under such decision would be to distribute that \$3,000,000-odd out of invested capital to security holders so it isn't in invested capital.

Q. There is nothing to prevent the company from doing that, is there?

A. Sure, there are many things. If they believe that the operations of the company are such they need it for [fol. 6720] working capital, that is the best reason I know of for not distributing it.

After all, they are the management and if they believe they need it so the business will be operated efficiently, I believe that is a perfect reason for not distributing it.

Q. And whatever amount the company happens to have on hand is, in your judgment, the correct amount they should have on hand?

A. No, indeed. I am not saying that.

Q. What analysis did you make to ascertain whether this \$4,000,000 of working capital was actually and necessarily needed for that purpose in this business?

A. I am not saying; you are reading into me some words I am not saying.

I never said that it was necessary. I said it is there and if it proves to be there and necessary, it is a part of invested capital and, therefore, must be so considered.

I never said it was necessary but I have relied upon the figures on the basis that, to date, I have heard no one say that it was unnecessary or unreasonable.

Q. Well, but you used the term "dollars needed" and I take it that the word "needed" is synonymous with necessary. Am I right?

A. And so far as the ~~investor is~~ concerned and the [fol. 6721] $4,000,000 is in here, it is needed, every dollar of it.

Q. Whether it is needed or not—

A. (Interposing) Unless you pay it back, it is still needed. You cannot pay it back to people unless you do something about it.

They paid their money for bonds, preferred stock and common stock and they cannot have it taken away from them unless there is a lawsuit.

* * * * * * * * *

Q. Mr. Coffman, what do you expect Panhandle Eastern Pipe Line Company to do with this amount of $2,551,034 which you are providing annually for depreciation, depletion and amortization?

A. Well, the company, as I have said, first receives that amount so long as it reports earnings in the form of cash and then through the cash account, it goes to other forms of assets as the management operates the business.

So long as the company continues to show growth, so long as the hazards continue to be in existence, so long as the company faces a condition whereby it may show [fol. 6722] increasing costs as it becomes a little more expensive to get gas, it will use the working capital to operate this firm as a going concern.

When it arrives at a point, however, where the accumulations are such that it is not necessary to spend these sums to keep this business operating at the same pace and working capital or cash begins to build up, I should then say possibly that the management would consider reducing its debt or calling its preferred stock and these would have to be done in the order mentioned, or paying a dividend on common stock, but until such time as they have such liquid position built up that they feel it unnecessary, that is, for all of it to be retained to operate the business efficiently, they will retain it in the business but when they arrive at that point, they will begin to reduce the outstand-

ing capital, pay off the bonds and thereby reduce the invested capital.

Q. And during the time such funds are actually used in the business, the rate payers receive no credit for the amounts provided for depreciation, depletion and amortization?

A. Well, I think that comes back to the basic condition, again, Mr. Littman, that this business was originally financed through the public with an understanding, so far as I know, that if the public invested money in the firm, [fol. 6723] the money was going to be efficiently handled, the company was going to be efficiently managed so that that investment would be secure and there would be a reasonable income thereon.

Otherwise, the investors would not have purchased these securities in the first place or otherwise financed this company.

So long as those securities remain outstanding and the capital has not been returned to the original investors, I do not see how it can be contended that the rate payer, that is, the consuming public or the consumers of this service can receive credit except as you, through efficiency, reduce costs and can pass that along to the customer and I still come back to my point if it is done any other way, it seems to me the matter will have to be taken to the Courts as to what the right of those original security holders is or was.

Otherwise, you are just confiscating capital. You are just telling them that you are going to take part of it away and, if you go on to an extreme example, you can see that no man can contend he has had a return of capital unless he is paid off.

If you take the extreme example here, for instance, of having rate reductions to the point where there are little earnings and you arrive at the point where the company is [fol. 6724] in liquidation and you convert the remaining property into the cash that you can get and pay bond holders off at 50 cents on the dollar and you allow nothing for preferred and nothing for common, it seems to me it is proved that the original investor does not get his capital

back, so who knows he is going to get it back until that time arrives?

Q. So the investor does not have his investment returned to him until he actually receives the cash in hand, is that right?

A. Absolutely, until he gets it and puts it back in his pocket or into his bank account, he just doesn't have it.

I mean, if I had the choice, for example, of having my money in the Panhandle Eastern without getting a return, as was the case for common stock here for quite a while in earlier years, or having it in my pocket to buy defense bonds or some other security, as I please, I would take the latter, any time.

Q. In other words, if the rate payer has paid the annual sum for depreciation, depletion and amortization to the corporation, the rate payer does not get any credit for such payment until the amount is actually distributed by the corporation to the individual investors, is that correct? Can you answer that yes or no?

A. Yes, so far as that particular item is concerned, [fol. 6725] but now you are talking about a very complicated situation as if it were a very simple one, but I will answer you, if every other thing remained the same except the charge for amortization and depreciation which amount was retained in the firm and not distributed in any form to the security holders, yes.

I do not see any reason why the consuming public should have any credit for that whatsoever.

Q. And that would be true even if this money paid by the rate payer for depreciation, depletion and amortization were placed in a safe deposit box by the corporation until the end of the life of the business and then distributed to the investors?

A. Well, that question, it seems to me, just cannot be borne out by the facts, Mr. Littman, because so far as I know and there certainly have been cases at point, I believe, although I cannot announce them, that if you continue to do that, there would be certainly some security holders who would immediately go to Court to ask the question, "Why is the management retaining such sums?"

I do not believe that condition could exist.

Q. Well, assuming that the condition did exist, under your concept of rate-making the rate payer would receive no credit until the investor had actually received the money at the end of the life of the property, is that right?

[fol. 6726] A. I say as long as the investor's money is retained in the business and he does not get it back, he expects a fair return thereon and security of principal included.

* * * * * * * *

Q. Now, if you will allow a return on an undepreciated rate base, isn't it only fair and proper that you allow a credit for interest accruals on this annual amount under a sinking fund arrangement?

A. Well, in so far as the sinking fund is built up and the bonds are called in automatically you reduce invested capital. When you accumulate a sinking fund, usually it works out that you buy in the bonds and, therefore, you reduce the invested capital.

[fol. 6727] Q. Now, Mr. Coffman, I wasn't referring to any particular sinking fund condition in bonds. I was referring to the sinking fund method of depreciation as distinguished from the straight line method of depreciation.

A. Well, now, we have got to get one thing straight, the terminology. I understand the sinking fund method of depreciation to be a method which is worked out, again, on an engineering basis as to what the proper charges are for allowance for depreciation and amortization. Now, if, when you charge that allowance against the operations in the operating statement, you at the same time establish on the assets side of the balance sheet an asset with cash and nothing else in it, which is building up, if that cash remains in such account and is not distributed in any form to the security holders, it is still a part of invested capital. On the other hand, if such fund is used to buy in securities, so that you lower your asset account and you, also, lower your invested capital on the other side, on the liability side, that is sound procedure. I merely say that, as long as that asset remains on the books it is still invested capital and the security holders will so contend.

Q. Well, as a rate-making formula, isn't it a fact, Mr. Coffman, that where a full return is allowed on an undepreciated rate base interest is credited on the annual ac- [fol. 6728] cruals to a sinking fund? Isn't that generally correct, as a rate-making formula?

A. Well, I would not want to answer as to that specifically. I would rather confine my answer directly to my approach and say that you have two people to consider, the investors, on the one hand, and the consuming public, on the other hand, and you cannot think of one or the other, you must think of both of them.

Q. Mr. Coffman, I was putting to you a very simple question that had to do with a rate-making formula. Now, we have heretofore discussed the straight-line method of depreciation. Now, I wanted to discuss with you, for a moment, the sinking-fund method of depreciation. Isn't it a fact that where a rate-making body fixes a rate base and does not deduct anything throughout the life of the property for depreciation, that in such event the Commissions invariably allow a credit for interest on the annual accruals for depreciation, depletion, and amortization? Isn't that correct?

A. Well, I think I will answer the question, I don't know. I have made no thorough investigation for this purpose on that. I think the best answer I could give to your question is, I don't know.

Q. Well, do you know what the sinking-fund method of depreciation is, Mr. Coffman?

A. Yes. A sinking-fund method of depreciation, as [fol. 6729] commonly used in accounting, is a method whereby, as you charge an allowance for depreciation, which is worked out on some engineering formula, you set up a fund as such to offset, if they complete the sinking-fund method.

If you are using just one portion of it, whereby you are trying to work out a schedule from an engineering standpoint as to the actual reduction per year through exhaustion or wear and tear, which may allow in the early years for more wear and tear or exhaustion and in the later years the reverse, that is the usual method as distinguished from the straight line. In other words, what they are trying to do there is to say that the amounts you charge at one period

are greater than the amounts you charge at another, whether it be the first years or the later years.

Q. Isn't it a fact that there is never an actual fund set up for that purpose, but that the fund is purely a theoretical device?

A. No, that isn't true, because I can go back in accounting and show you examples where depreciation funds in past have been set up very definitely. That is what I want to be sure you understand.

Q. You are not prepared to say whether an undepreciated rate base is used in connection with the sinking fund method of depreciation?

A. No, I have not made any particular investigation of [fol. 6730] that for this particular study.

Q. That is, you do not know whether it is or is not used?

A. That is right.

Q. Well, now, of course, if your annual allowances for depreciation, depletion, and amortization were determined by the use of a sinking-fund method, your annual accruals would, of course, be lower, would they not, than the amount which you have used of $2,551,000?

A. They might or might not. To answer your question, so far as my method of approach is concerned, if the sinking fund were to be used or had been used, I would then find out what the schedule from the engineering standpoint was that was operating at the time, and use such amounts. It would work no differently under my method of procedure than what I have done on what we have been terming the "straight-line method." The item might be different, but the over-all result on 25 years, if that is still the estimated engineering life, presumably, if the figures were accurate, would work out to the same point.

Q. You then think that the sinking-fund formula could be applied in connection with your annual allowances for depreciation?

A. Oh, I am sure it could.

Q. And the annual accruals would then be much smaller [fol. 6731] than the $2,551,000 which you have allowed, depending on the rate of interest used. Is that correct?

A. It would depend on the schedule that was worked out. As I say, on a sinking-fund basis you will work out

a schedule of depreciation for the estimated life, the same as you will work out the estimated length of life for a straight-line method, and you will build up a schedule accordingly.

Q. And the amount required annually would, of course, be less under any sinking-fund arrangement than that which you have determined under your theory of $2,551,-034? Isn't that correct?

A. Well, that is correct technically, so far as the interest involved in the sinking fund is concerned, but practically, if the actual fund isn't established whereby you can invest the sum for the interest, it would make no difference, as I see it.

In other words, a bookkeeping entry merely to take interest on something that doesn't exist, even though you say it is a sinking fund, means nothing so far as my particular approach is concerned, because I am still, as I have shown here, talking about the over-all revenue that is needed by management to get at, finally, this amount of dollars that is needed to operate this plant efficiently, render service to the public, and get the last column that we have been referring to from time to time to maintain [fol. 6732] the credit of the corporation and the investment in the public's eyes.

Q. What would be improper about using a sinking-fund method for the purpose of determining the amounts required to be returned to the investors when the gas reserves are exhausted?

A. I did not say there was anything improper about it. It is one method that is actually used.

Q. And you would not claim that the use of such a method would be improper, would you?

A. No, not at all.

Q. For purposes of this proceeding?

A. For purposes of my study and my approach.

Q. Well, do you know, Mr. Coffman, what your annual claimed amount of $2,541,034 for depletion, depreciation, and amortization would be if the sinking-fund formula were to be applied for 25 years of remaining life at an interest rate of 6½ percent?

A. No, I do not know what the figure will be.

Q. Now, you could make such a calculation, could you not?

A. Yes, I can work it out; not here, I mean not in a short space of time, but I can easily work it out, yes.

Q. Well, if we gave you the sinking fund tables, the interest tables, you would not have any difficulty in working that out between now and tomorrow, would you?

[fol. 6733] A. No.

Q. Are you aware of the fact that this Commission in the Natural Gas Pipe Line Company of America proceeding used the 6½ percent sinking-fund formula? Did you know that?

Mr. Culton: Applied to what base?

The Witness: I do not recall specifically all the details, but I did read the general release on the Natural Gas Pipe Line Company.

By Mr. Littman:

Q. Did you know that in that proceeding the Commission found that an annual allowance of $1,557,852 would amortize $78,284,009 in 23 years, using a 6½ percent interest rate?

A. I do not recall those figures, no.

Q. Assuming the correctness of my reference to the Commission's opinion in the Natural Gas Pipe Line Company proceeding, why should it be necessary for you to require $2,551,034 per year for 25 years to amortize a fund of $63,775,839?

A. Well, I cannot, I believe, answer that question unless I have time to refresh my memory on that decision and see what the factors were that were involved and the specific amounts that were discussed. I have made this study, and on the basis that I have made it and the approach I have used and the figures I have used, all of which have been defined to this point, I say that the amount [fol. 6734] stated here is required until some portion is paid off to the security holders which will reduce the invested capital.

Q. Well, you have heretofore testified that if the Commission were to find an annual return for amortization, depreciation, and depletion in an amount less than $2,551,034, you would reduce your total dollars needed, accordingly. Isn't that correct?

A. I believe I said that if it were shown that the length of life of 25 years proved to be wrong, so that a new figure would be established, why, then I would adjust the accounts accordingly and go on on whatever the basis was so determined.

Q. Do you have any opinion as to the correct interest rate to be used in this case if the sinking-fund method of amortization were used?

A. Well, at the moment I do not have a specific rate, but that can be determined. I have made a study which is shown as a part of this over-all exhibit entitled, "The Investors' Appraisal of the Risk of Capital", which I think closely approximates what the investing public is saying about this particular company and the type of risk it is as of the date we made the study. That should give you a close approximation.

Q. I take it from your answer that in your opinion the rate of interest to be used in connection with the sinking [fol. 6735] fund established for depreciation, depletion, and amortization should be the same as the rate of return fixed by the Commission. Is that correct?

A. Well, I think there you have to distinguish between two things. So far as the sinking fund is concerned, I would say that that still had some relationship to conditions that you actually can find in the financial markets at the time as well as what the Commission might find from the standpoint of rate of return, as I believe you are using it, to a property which renders a public service, that is talking about the consumer rate.

Q. Well, does that mean that the interest rate for the sinking fund might be higher than the rate of return allowed by the Commission on the rate base?

A. Well, that all depends on the factors taken into consideration. I would suppose that if the Commission determines a rate which is based upon all the facts to be considered, including the investor, that rate ought to approximate fairly closely the amount. On the other hand, if it follows a line of discussion that I understood you were making for a while, wherein you consider for the most part the customer and let the investing public go by the board, why, then I think there could still be some dispute about it.

Q. Can we not agree, generally, in principle that the interest rate to be used on accruals to a sinking fund for

[fol. 6736] depreciation, depletion, and amortization should closely approximate the rate of return fixed by the Commission on the rate base used by the Commission?

A. Well, I think my answer still is that if all the factors, the two most important ones, as I see it, are taken into consideration and given thorough weight, namely, the customer for the service, on the one hand, and the investing public, on the other hand, yes. If it does not, I still think there is some further study which would be warranted in trying to ascertain the figure. Now, whether they closely relate will depend upon the study. I do not believe I can answer any closer than that.

Q. In other words, your answer to my previous question would be "Yes" if the Commission were to adopt your suggested rate of return. Is that correct?

A. No, that would not be correct, because I have not given a rate here. I have talked about so many dollars.

Q. Well, if the Commission were to accept your method?

A. Well, then, if the Commission were to accept my method, I still have not arrived at a dollar amount, but if the Commission would tell me what the rate base is that they have determined and I use my method with the figures so shown for the moment, then I can tell what the rate is, but at the moment I cannot tell any rate because I do not know the base and until you tell me the base fixed by the [fol. 6737] Commission I cannot tell you any rate.

Q. I believe you stated a moment ago that you could tell me the interest rate which should be used for purposes of a sinking fund for the accumulation of the amounts required annually for depreciation, depletion, and amortization from an examination of the investors' appraisal of risk of capital.

A. No; what I said, I think, Mr. Littman, was that in connection with the study, I made, also, a study entitled "Investors' Appraisal of the Risks of Capital", which, I believe, could be used as a basis to help determine such a figure.

Q. Now, I refer you to your Exhibit No. 64, Appendix C, page 131, on which is shown for Panhandle Eastern Pipe Line Company the "Investors' Appraisal of Risks of Capital" as 9.10 percent. Is this the percentage figure which you had in mind?

A. No, not necessarily, because that figure there, as clearly indicated, is a figure calculated on what I would describe as the over-all capital. In other words, as you can see clearly from the exhibit you cite, it includes common stock, preferred stock, bonds and other long-term debt, and the over-all coverage there is 9.10 percent.

Now, obviously, you have an admixture of items in there ranging all the way from common stock, which might be rather speculative, to their present first mortgage bonds [fol. 6738] which are carrying a rate of 2.74 percent. I merely say that, from the basis of this study, if I were to pursue an investigation, I think that I could determine a rate. I am not saying that it is 9.10, because this includes all the capital of the company and there are different forms. If you can tell me upon what basis the sinking fund is to be constructed, why, that would assist in determining what rates seem to be applicable in view of the circumstances.

Q. Well, you are the expert here. Suppose you tell me what rate would be properly applicable to the sinking fund in the light of the knowledge which you have of investors' appraisal of risks of capital.

A. As an expert I say I would want a little time to study that before I made an answer. This is a perfectly new problem to me and it is one that I do not believe any expert would be wise, upon his feet in a few seconds, to give an answer. As a matter of fact, I do not think he could, unless he made the specific study you mentioned, and I have not made such a study.

Q. Would you expect the amount to closely approximate the 9.10 percent figure shown on page 131 of Appendix C?

A. I really have not any idea, Mr. Littman. As I say, the rates go all the way from 2.74 for the bonds, as shown in my study, Exhibit No. 63, I believe it is.

Q. What is the over-all rate which you have applied to [fol. 6739] the invested capital to secure the $5,064,821 of "Current Capital Requirements", shown in your Chart No. 37?

A. Well, there are various rates.

Q. Well, isn't that rate shown in your table for Chart No. 26 as 7.99 percent?

A. Chart No. 26, is that right?

Q. Yes.

A. Well, what that chart shows there is that there are varying rates which I have discussed. There is the 2.74 percent for the bonds, the 8.45 percent for the preferred stock, and the 12 percent for the common.

Q. Now, if you will refer to your Chart No. 26.

A. That is what I am looking at.

Q. Yes. You show there the actual amount of bonds, preferred stock, and common stock, the latter including surplus outstanding, as of June 30, 1941, do you not?

A. Yes, I do.

Q. And in your table for that chart, to wit, Chart No. 26, you show the over-all "Yield Rate" applicable to the 7.99 percent?

A. That is correct.

Q. Now, that is the yield rate which you recommend be adopted by this Commission for application to the actual invested capital as of June 30, 1941. Isn't that correct?

A. No, that is not correct, because, as I have just [fol. 6740] finished stating, you have long-term debt in at least four classifications, preferred stock in at least two classifications, and the common stock including surplus. Each of those classifications takes a different rate.

Now, the way you get the 7.99 percent is to first consider each of the various classifications of the capital structure and then strike an average. Well, now, obviously, if you change the proportions from one to another, which will happen as you go along if you are calling in some bonds or building up a sinking fund for it, or if you refinance, as was the case beginning along in February 1941 by the company, I do not know just what that figure would be and I would want to make some calculations on it before I gave an answer.

Q. Well, why do you show this over-all rate of 7.99 percent in your table for Chart No. 26, if it does not mean anything and if it is not to be used for any purpose in these proceedings?

A. Well, it does have a meaning because it is based on each of the figures, but I am still telling you that, so far as the sinking fund is concernd, I want to know from you, if you are going to be technical about it, what kind of

capital you are talking about. After all, all the capital has to be amortized. That includes common stock. Now, if you are going to talk about that, it is going to be 12 percent, if the rates remain the same as they were as of June 30, 1941.

[fol. 6741] If it is going to be preferred stock, it is the figure shown there, 8.45 percent. If it is the bonds it is 2.74 percent and I say I would merely like to make an investigation before I give a particular answer, if you are going to work out a new schedule.

Q. In other words, you are certain that if you were to make a study of the problem of the proper interest rate to be applied for a sinking fund calculation for depreciation, amortization and depletion, your study would be predicated upon the same general principles as those reflected on your Chart No. 26 of Exhibit 65?

A. Well, rather than say predicated, I would say that I would certainly take into consideration all those factors.

Q. Now, if Panhandle Eastern Pipe Line Company had as of June 30, 1941, only common stock outstanding in place of preferred stock and bonds, then the rate would be necessarily 12 percent?

A. Well, there, again, as I say, you are changing two factors right off. The common stock in Panhandle Eastern at the present time is twice removed from the capital and I do not see how you can reason until you make a study on the basis of the assumption you make.

Q. Mr. Coffman, in computing your annual allowances for depreciation, depletion and amortization, which total [fol. 6742] $2,551,034 per year, have you allowed any credit for salvage?

A. In that particular figure I have allowed nothing for salvage because I could not find available in any figures any estimate for salvage.

I have worked these figures out at the moment on the assumption that there is no salvage.

Q. Well, you know that there is going to be considerable salvage, do you not, at the end of 25 years?

A. No, I do not know that at all. I am very much afraid it is going to work the other way around, that there won't be any salvage.

Q. In your judgment there is not going to be any salvage at the end of 25 years hence on all of the property of Panhandle Eastern?

A. To state the question a little differently, looking at it from the standpoint of the investor, the investor would not believe, in view of the facts that are available on this company today, taking as long-run a view point of 25 years, which certainly includes, that he can see any salvage left not have I taken any; nor have I seen any engineering estimates which include them.

I believe it would be a hard package to sell the investor.

Q. You have not seen any engineering estimates that [fol. 6743] include an allowance for salvage?

A. In this firm, no, because I used the annual reports which are the only thing available to the stockholder. I did not see any facts there in regard to that, neither did the investor and I think he would be rather hard to sell on that idea.

Q. Did you inquire whether there were any exhibits offered in this proceeding which showed whether there would be any salvage?

A. No, and for the reason given, that I have taken these figures from the annual reports which are the only figures that are available to the prospective investor, as well as the present stockholder.

Q. Do you know of any certified public accountant that would certify a statement of this company without giving effect to salvage?

A. If he has given effect to it, we have included it because we used the certified statements and we took the various figures right off the books as you know; so if he did it, we did it and he did not do it, we did not do it.

Q. But you do not know what method had been used or has been followed by the company in determining their amounts of amortization, do you?

A. No, I did not make any investigation of that.

[fol. 6744] Q. I believe you stated in your direct testimony that your annual provision of $2,551,034 for depreciation, depletion and amortization includes maturity and sinking fund provisions.

The Witness: That is right.

By Mr. Littman:

Q. How would your allowance be affected if the company had no outstanding debt?

A. Well, if the invested capital were represented solely by preferred stock presently outstanding but in larger proportions and common stock in larger proportions to take up the amount now represented by bonds, you would find the same amount of invested capital obviously as now stated upon the exhibits and one twenty-fifth of that amount would be taken.

Q. In other words, your allowance would not be affected if the company had no outstanding debt. The [fol. 6745] allowance would still be $2,551,034, wouldn't it?

A. If that were invested capital, it still would be, yes, sir.

Q. In other words, I would like to know what effect did you give in arriving at your allowance of $2,551,034 to the maturity and sinking fund provisions of the present debt?

A. Well, in that particular connection the consideration was not made there. Where the consideration was made as to the sinking fund provisions and actually given weight was when the calculation was made as shown in Chart No. 37 to arrive at the figure of $5,064,821.

Mr. Littman: Will you please read that answer?

(Whereupon, the last answer was read by the reporter.)

By Mr. Littman:

Q. But in your text accompanying Chart No. 31, you make a reference to "this amount" which, of course, refers to $2,551,034, do you not?

A. Well, that just means that we are working now at an amortization figure to retire the capital and I wanted to make clear that when I did that I considered all the various provisions.

I did not say there that I was giving a specific weight at that point. I merely say that the amount, of course, includes maturity and sinking fund provisions.

[fol. 6746] I am aware of the fact that they were required. I may have been rather faulty in my examination if I had not made such investigation.

Q. Well, are you stating that your maturity and sinking fund provisions are made in two places, first, in the amount of $2,551,034 and, secondly, in the amount which you just named, "Current Capital Requirements" in the amount of $5,064,821 shown in Chart No. 37?

A. No, I did not say that nor did I imply it.

Q. Well, would your provision of $2,551,034 be any different if the maturity provisions on present debt were longer or shorter?

A. Well, if the provisions were such that the bonds, the bond section of the capital structure were to mature in a much shorter life than the 25-year estimate, then there would have to be a segregation for that portion of capital, but your question originally asked me if there were no funded debt whatsoever outstanding, but, other forms of capital, was what I answered.

Namely, that you would still have the $63,775,839 and that has to be amortized if these assets are going to be exhausted in 25 years.

Q. Well, Mr. Coffman, I am at a loss to understand what the maturity and sinking fund provisions had to do with your calculation of this $2,551,034 shown in Chart [fol. 6747] No. 31, which latter figure was computed simply by dividing 25 years into the sum of $63,775,839 of invested capital.

A. Well, I think that that probably is fully explained in Chart No. 17 where I give the details to the funded debt, which is the only issue at point.

There the issues of the bond are so worked out to show the present schedule of debt retirement and to show the outstanding amount of debt through the years to the maturity date of the bonds.

Q. How did the information or data shown in Chart No. 17 affect the very simple calculation of dividing 25 years into $63,000,000-odd?

A. Well, they did not have any great material effect for the simple reason that so far as the length of capital was concerned and the maturity date of the bonds, they are about one and the same thing.

In other words, the bonds are not to mature until 1960 and the 25 years that we are talking about would be at

approximately the same time, so there is very little discrepancy.

Had you had the bonds, on the other hand, mature, let us say, in 10 years and the full invested capital going on for 25 years, which is the estimated length of life, then there would have been some additional consideration given. [fol. 6748] If so happens that the sinking fund will take care of the debt retirement as a separate part of the overall capital.

Q. Well, if your bonds mature in 20 years and you have provided for a 25-year life for purposes of amortization, depletion and depreciation,—isn't that correct?

A. That is correct.

Q. Now, what does the 20-year life have to do with this 25-year life that you actually used for purposes of Chart No. 31?

A. Well, I merely say that there are two observations to be made. In the first place, the debt so happens to expire only a short time prior to the estimated life as used in this study, so that per annum, it would not make much difference.

Actually, from the standpoint of debt retirement the schedules shown indicate how the outstanding debt will diminish as the years go by and the sinking fund on the bonds operates.

Q. Now, referring to Chart No. 17, isn't it a fact that the lower left-hand portion of this chart clearly shows that the schedule of outstanding debt indicates that your invested capital in the enterprise is going to decrease through the years steadily until 1960? Isn't that correct? [fol. 6749] A. What that indicates is that as the provisions of the bonds operate, a sinking fund will be built up, which sinking fund presumably will be used to buy in certain bonds.

As those bonds are purchased they will retire or reduce a part of the invested capital. If, meanwhile, the company continues to go on and need invested capital of $63,000,000 or more, that will be supplied either through earnings or new financing.

Part of that is already being accomplished at the present time as we know, that is, the company is contemplating new financing.

Q. Mr. Coffman, does your estimated annual provision of $2,551,034 to return capital when gas reserves are exhausted hold good for the year ended June 30, 1941?

The Witness: May I have the question, please?

(Whereupon, the pending question was read by the reporter.)

The Witness: I think is does, yes.

By Mr. Littman:

Q. Will you again turn to Chart No. 31? During that same period the company actually charged the amount of $2,316,560 for depreciation, depletion and amortization. Is that not correct?

A. That is correct, but when you are talking about this report you have to relate the figures that you are referring to, to their base and in that particular case [fol. 6750] where you are talking about the $2,551,034 you will see in the explanatory note that it is based on a return of capital $63,775,839 which was fully explained in Chart No. 27 and was based upon the assumption that the preferred stock would be eliminated and the company's capital structure thereafter would be bonds and common stock.

Q. Well, I thought you just said a minute ago that this estimate of $2,551,034 held good and was properly applicable to the year ended June 30, 1941.

Did you answer that question that way?

A. I answered the question incorrectly. I did not know that you were trying to trip me up because I thought in my study it was clear as to how the thing had been based and if it is not clear I have just verified it by my answer.

Q. You understand this is your exhibit, Mr. Coffman. I don't doubt that you know more about this exhibit than I do, so I hope I am not going to be able to trip you up, but I would like to know now to what year this $2,551,034 applies.

You now say it does not hold good for the year ended June 30, 1941.

A. It is the amount, as I have explained before, that has been calculated upon the assumption made of a change in the capital structure and based upon the operations of the company with the adjustment in figures which I have [fol. 6751] already described this morning and on Saturday.

Q. Well, is this annual provision that you provide here one that hops around, jumps up and down from year to year, or is it something that can be used over a period of time? Now, which is it?

A. I think it very definitely can be used. If you make the assumption that the company will refinance its present stock by means of 50 percent in bonds sold at $3.25 percent and 50 percent of common stock sold at 12 percent, you will then have a total invested capital of $63,775,839 which is comprised of bonds and common stock.

If you then assume a length of life of 25 years to account for full exhaustion of the property and take one-twenty fifth of the amount you get $2,551,034.

The reason that it was assumed that there might well be considered for purposes of this study a change in the capital structure is because of an exhibit—of a chart which is contained in this Exhibit 65 which indicates that the company might well consider the revamping of its capital structure.

That chart which I referred to is Chart No. 25, wherein I compare various natural-gas pipe-line companies and to ascertain whether or not they have preferred stock outstanding.

Q. Well, now, under the present capital structure, you [fol. 6752] only have $10,000 less, do you not, namely, $2,541,034? Is that correct?

A. Yes, that is correct.

Q. Well, let's take that figure under the present capital structure, $2,541,034. A. Yes, sir.

Q. In order that we have no further quarrel about the amount. Now, was that the proper amount in your opinion for amortization, depletion and depreciation ap-

plicable to Panhandle Eastern Pipe Line Company for the year ended June 30, 1941?

Now, I think you can answer that yes or no, can you not?

A. If the 25-year length of life is correct, I answer "yes" and I base that on Ralph Davis' statement which I have referred to before.

Q. Now, is it your testimony that the company, itself, has understated its depreciation, depletion and amortization for the year ended June 30, 1941?

A. Well, so far as my study is concerned, using the sources I did, getting the best estimate that I could in regard to the length of life of the properties, the figure of $2,541,034, which is arrived at as already described, seemed the reasonable figure to use and in so far as it was in excess of the other, I am not prepared to say why the difference existed.

[fol. 6753] I merely am defending and describing why I arrived at the figure I got.

Q. In your opinion, then, the company did not set aside a sufficient provision for depreciation, depletion and amortization for the year ended June 30, 1941? Is that your testimony?

A. If the length of life proves to be 25 years, ~~that is~~ exactly my testimony, yes.

Q. And, according to your testimony, the company set aside in its reserves for depreciation, depletion and amortization $224,470 less than it should have set aside and provided for that purpose in the year ended June 30, 1941?

A. That is correct.

* * * * * * * * *

[fol. 6756] Q. Mr. Coffman, will you please refer to Chart No. 37 of your Exhibit No. 65?

This chart shows, among other things, that in your opinion, Panhandle Eastern will require $3,516,000 annually for operations and maintenance expenses. Is that correct? A. That is correct.

Q. How much did the company actually expend, according to its income statement, for operations and maintenance for the year ended June 30, 1941?

A. $3,196,797.

Q. Chart No. 29 of Exhibit 65 shows the figure which you just named as "Actual 12 Months Ended June 30, 1941". Is that correct? A. Yes, sir.

Q. Now, you have added an arbitrary 10 percent or $319,679 to the company's claimed expenses for the "Projected" figure which is shown, again, in Chart No. 37. Is that correct?

[fol. 6757] A. Well, I have not that specific amount in mind. The figure that I used in Chart No. 37 of Exhibit 65 was $319,203 higher than the amount shown for the 12 months ended June 30, 1941.

Q. Now, you added this additional amount to the operations and maintenance expenses for the year ended June 30, 1941, in order to secure the amount for the future without making any study of the books and records or any examination of the detailed items of operations or maintenance expenses. Is that correct?

A. I did it without examining the books and based it upon an analysis of the trend of the company's affairs over a number of years as I could interpret them from the various published statements and, also, from a careful study of the trend of material prices and material costs and wage-rate trends that had been going up in an upward move for the last two or three years.

Q. But you did not make any study of the books and records in arriving at this 10 percent increase?

A. No, that is correct.

Q. That is, you started your computation on the assumption that every dollar claimed by the company was properly includable for rate-making purposes without making any investigation of the books and records?

A. You have added in there, again, "For rate-making [fol. 6758] purposes".

Confining the answer to the study that I made under the approach that I used, taking the figures from reliable statements which had been reviewed by public accountants, I believe that the figure was within reason.

Q. Well, the statement that you relied upon as the basis of adopting the amount claimed to have been actually expended by the company for maintenance and operations

for the year ended June 30, 1941, showed the details of these maintenance and operations expenses to what extent?

A. Well, it showed the figure as I have broken it down in the exhibit. In other words, the figure for operations, as such, was a total figure and the figure for maintenance was a single figure.

Q. In other words, you had no details before you from the statement that you examined showing the individual items included within the meaning of the terms "Maintenance" and "Operations"?

A. That is correct, but I did have a series of figures which gave me some idea of trends. For example, for the 12 months ended June 30, 1940, operations, taking the single figure, was $2,561,71^ ^8.

The same figure for the 12 months ended June 30, 1941, was $2,902,352.57 and so on.

I have the various other figures available for the years, [fol. 6759] so that you could get some very good idea as to what the trend was on those items for the company and then, in addition, as I say, I was familiar with other statistics which gave a good idea of what wage rates were doing by way of trend, what material costs were doing and so forth.

Q. Now, I believe you stated that you examined statements that had been certified by a certified public accountant.

A. Generally, you mean?

Q. Yes. A. Yes, I have.

Q. You have had no such statement for the year ended June 30, 1941, did you, but had such a statement for the periods previous thereto ending with December 31, 1940. Is that correct?

A. That is correct.

Q. Now, is it your understanding that a certified public accountant passes upon the propriety of items of maintenance and operations from the point of view of rate making?

A. I do not think that the public accountant, unless he has the specific assignment, has that in mind, but he does have in mind accounting practice which is believed

to be sound and which is acceptable under present-day conditions to most regulatory bodies.

In other words, they are certainly not certifying to [fol. 6760] various practices which they believe to be unsound, although at the same time they are not making a rate study unless they have been retained to do it.

Q. Mr. Coffman, even if you had made an investigation of the detailed operations and maintenance expenses, would you feel qualified to express an informed judgment or opinion as to their propriety for rate-case purposes?

A. Well, there, again, Mr. Littman, I am making a study which I have explained, using an approach which I have explained. From the standpoint of this approach I would feel qualified to do exactly what you say.

Now, when you talk in terms of rate-making, again, I get confused because I do not know whether you are referring to the classical theory or some other formula, but if I can confine my statements to this approach, my answer is "yes".

Q. You feel competent to examine the detailed operating statement of a company and to express an informed opinion as to the amount of maintenance and expenses required by a company such as Panhandle Eastern Pipe Line Company for a given year?

A. I think on a thorough investigation and having such checks as are necessary with various executives of the company, I can form a pretty good opinion as to drawing a distinction between what would be legitimate [fol. 6761] charges to capital and what would be legitimate charges to income, as I am using this approach, yes.

To me that is not greatly different than any other analyses which we are doing on financial and operating statements or analyses of a company and we do hundreds of them throughout the year.

Q. Do you feel that you could express a qualified opinion in that regard with respect to the detailed operations expenses?

A. Upon thorough study I think for use in my approach that I could have a very good reliable answer, yes.

Q. I believe you have heretofore testified that you are not an engineer? A. That is correct.

Q. And you have not made such a detailed study in any event, have you? A. No, I have not.

Q. And you have never seen the property of Panhandle Eastern Pipe Line Company, have you?

A. I have seen parts of it. I have not been over the entire property, no.

Q. What part have you seen?

A. Well, I have seen certain parts of it when I have been to their Kansas City office, I have seen certain parts of their company when I was in the Texas area.

[fol. 6762] I was not working for this company, but when I was going through the particular area, I have seen various parts of the pipe line through some of the country that it has crossed.

Q. Did you ever see any of the pipe, did you ever make any examination of the pipe in the system? A. No.

Q. I take it that the property of Panhandle Eastern which you have seen was by a rather casual observation, was it not?

A. Yes, I was not making an investigation of it. You asked me if I had seen part of the property and my answer is yes, but I was making no study of it.

Q. And the part that you saw was a very small part of the whole, was it not?

A. Yes, a small portion of the whole.

Q. Of course, among the matters to be decided by this Commission by investigation is whether the amount claimed to have been expended heretofore by Panhandle Eastern Pipe Line Company for operations and maintenance are properly allowable for purposes of this proceeding.

A. I should suppose that were true.

Mr. Wheat: Mr. Littman, I am wondering whether you really meant what you said there, that amounts expended in the past were properly allowable.

[fol. 6763] You understand, I do not think you meant to lead the witness astray with respect to that but I suppose you had in mind amounts to be allowed in the future, did you not?

Mr. Littman: Yes, I had that in mind and I had particularly in mind the question of past expenditures to be used as a guide.

Mr. Wheat: As a criterion?

Mr. Littman: Yes, as a guide for the future.

Mr. Wheat: I so understand you, but I just wanted to draw that particular matter to your attention.

Mr. Littman: I think I might have made my question clearer.

By Mr. Littman:

Q. You had such an understanding, did you not, of my question? One of the things to be decided by this Commission, of course, is the proper amounts to be allowed in the future for maintenance and operations?

A. That is correct. I understood that.

Q. Of course, you understand that such an investigation involves a detailed study and examination of the various accounts and practices of the company in that regard? A. By the Commission?

Q. Yes. A. Yes, I so understand.

Q. Now, is this increase of 10 percent for the pur- [fol. 6764] pose of taking care of an increase in labor and materials incurred in maintenance and operations?

The Witness: May I have the question read?

(Whereupon, the pending question was read by the reporter.)

The Witness: I do not believe that question is clear to me, Mr. Littman.

By Mr. Littman:

Q. Well, what is the purpose of this 10 percent increase that you have allowed after June 30, 1941?

A. Well, the purpose of that was to register what we believe to be a fact in this country at the present time, that an emergency has changed conditions, other factors in the country, external conditions, economic conditions have changed so that we have been having increases in wage rates, shortening of hours, greater demands for materials, therefore, higher prices, and, of course, there are some scarcities.

Those factors, all of them, so far as the management is concerned, are going to have an influence on their cost of operations and maintenance.

I felt that in making an estimate of 10 percent I was making a very conservative one. If I had to make a study today, with the additional information that I have at hand, I should say it should be higher, so that the purpose was merely to register the economic conditions that [fol. 6765] are having a bearing on the cost of operating this business.

Q. Was this 10 percent increase based upon a study made by Standard and Poor's Company?

A. Not on a direct study. We are commenting upon these things [dails], as you know, in our various printed services and as conditions change we are changing our opinion. That is a part of our business.

Q. Well, did you assume that all labor and all things purchased by this $3,196,797 shown in Chart No. 29 and Exhibit 65 during the year ended June 30, 1941, would increase 10 percent?

A. I had a specific figure, as shown in the financial statement, covering the 12-month period ended June 30, 1941, which showed a total for operations and maintenance of $3,196,797.

In view of all the conditions, as we see them today, with rising trends of commodity prices, raw material prices, wages and so forth, I used a simple method of saying that certainly on the average these items would be at least 10 percent higher and, as I say, if I were making the study today I would say it was even higher than that.

Q. Well, you did predicate the increase primarily upon the proposition that in your opinion, first, the cost of labor would increase by 10 percent. Is that right?

A. It is correct.

[fol. 6766] Q. And, secondly, that the cost of materials would increase by 10 percent? A. That is correct.

Q. Will you enumerate the major items of maintenance and operations and the amounts of each for the year ended June 30, 1941?

A. I do not have that figure or those figures.

Q. You never did have them? A. That is correct.

Q. Well, can you state generally what is included among these operations and maintenance expenses, giving us the major items?

A. Well, the major items are already included in the two captions. The major items are wages and materials as far as my calculations are concerned.

If you can present me with the company's exhibit, with a detail statement, I can easily read them off, but I admit I did not have them to begin with nor did I use them.

Q. Well, here you have an item of operations in the amount of $2,902,353 for the year ended June 30, 1941.

Suppose you state what you consider to be the largest item of operations of Panhandle Eastern Pipe Line Company.

A. Well, I would not attempt, Mr. Littman, to enumerate those without looking at the statement, because, in the first place, for this study I did not use the details as [fol. 6767] I have already said.

Q. Well, how do you know the costs of operations are going to go up, if you do not know what elements are included within the meaning of the term "operations"?

A. Because, in so far as their materials and labor are involved, this company cannot be the one exception in the country that is going along without suffering the increases that everyone else is going to have to meet.

Further than that, I state, again, the answer that I [have] you wherein, without any major changes in the business, the operations charges as made on the company statement increased from $2,561,715 for the 12 months ended June 30, 1940, to $2,902,352 in the 12 months ended June 30, 1941.

That is about $400,000 of increase and they have not yet faced the largest increases that probably will be forthcoming from the emergency period.

Q. Well, suppose you name three or four large items of operations of this natural-gas pipe-line company.

A. Well, I do not know to what detail they break down their various accounts.

Q. You do not need to give it to me by accounts. Just name a few items.

A. Well, for example, in their operations they are operating and maintaining the pipe line as such, they have stations all along the line with telephones and tele- [fol. 6768] graphs which they are maintaining.

They have men at various stations to report, they have other men to take care of valves and cut-offs, they have booster stations, they have men where the line has been looped, so there are repairs all along.

If they have an explosion, for instance, or a flood so that a part of their pipe is washed out, there are men there immediately to take care of that and so on.

Q. What percentage, would you say, of the total main tenance and operations cost for the year ended June 30, 1941, is embraced by the items which you just named?

A. I would not say until I see the figures.

Q. You would not have the slightest idea, would you, even if you did see the figure—

A. (Interposing) Yes.

Q. Well, I mean without seeing the figures. Would you have the slightest idea without seeing the figures?

A. I would not know now because I have not seen the figures.

Q. Well, you do not know from your own general knowledge what percentage of operations and maintenance is related to the items which you just named?

A. Stating it the other way around, for purposes of this study I did not have the detail figures, nor did I think that they were needed for my particular approach.

[fol. 6769] Q. Well, the answer is you don't know?

A. I say I don't know and I don't need them for this approach, taking a view from the investor's standpoint.

Q. You do not know now and you never did know?

A. Of the detail figures, that is absolutely right.

Q. Well, not only of the detail figures, but of the percentage, generally, of operations and maintenance expenses which comprise the elements and items which you just named?

A. No, but I still say that I know that there was \$350,000 of increase between two different 12-month periods

and that was reported to the stockholders who have an investment in this company.

They know, also, of the rising trend of prices and they are taking that very definitely into consideration. Assuming that someone doesn't come along and show that these figures are all improper or misstated, they presumably stand in totals.

Q. Will you read the revenue figures for those corresponding periods?

A. Yes. The total revenue figure, the gross revenue which is gas, gasoline and other, was $13,096,556 in round figures for the 12 months ended June 30, 1940, and $14,336,448 in the 12-month period ended June 30, 1941.

Q. And what is the difference between the revenue [fol. 6770] figures?

A. The difference in the total gross revenue figure is $1,239,892.

Q. Now, can you state what part of the increase between the two periods which you mentioned, that is the increase in maintenance and operations expenses, was occasioned by rising wages and materials costs and what part was brought about by the requirements for the purpose of securing this additional revenue?

A. No, I cannot state that figure.

Q. As a matter of fact, the operating costs per dollar of revenue have been going down, according to the figures that you just read. Isn't that correct?

A. That is per unit sold, yes.

Q. And those are figures upon which you relied in part to secure this 10 percent increase over the figures as of the year ended June 30, 1941?

A. Which months did I rely upon?

Q. Operations and maintenance expense figures for the preceding years.

A. Well, I relied upon the actual figures for operations and maintenance as shown in the various financial statements, yes.

Q. Now, what other items are included within the meaning of the term "Operations", as you have used it [fol. 6771] on this Chart No. 29 of Exhibit No. 65?

A. Well, as I say, Mr. Littman, I do not think I can go into much more detail unless I have the company's figures before me and read them off.

I did not use them for this study because I did not feel it was necessary. What I was doing, as I have explained previously, was looking at this from the investor's point of view who has only the various financial and operating statements that are published in order to form a judgment. That is exactly what I had to form a judgment.

Q. Well, do these operations include bond interest, for instance?

A. No, they do not include bond interest.

Q. Do they include rate-case expense.

A. I do not know.

Q. It might?

A. I would not say. I have not made a study, so why should I go on guessing with you?

Q. Well, if you do not know what is included in the meaning of the term "Operations", as you have used it on your Chart No. 29, I am at a loss to understand how you could determine that the amount was going to increase 10 percent after June 30, 1941.

Now, can you explain how you can arrive at such a conclusion without knowing any more about the details than [fol. 6772] that which you have told us?

A. Yes, I think it is very reasonable, to me, Mr. Littman, just as, right now, for example, I do not know and I don't suppose the company knows what the income, taxable income for this firm is going to be, but they know that the taxes, when they pay them, so far as rates [as] concerned, are going to be much higher than they are now.

Well, I know that about wages and materials and yet I do not know the individual items any more than I know what the taxable income is, but I know it is going to be higher, so do I know what the wages and materials are going to be higher and that the total on operations figures is going to be higher.

Q. We are going to take up the subject of taxes a little later, but confining ourselves for the moment to maintenance and operations expense, you cannot give us any further explanation than that which you have already given as to why you expect a 10 percent increase?

A. I think the Exhibit 65, Chart No. 29, states the situation exactly. There was a figure of $3,196,797 which was recorded for the 12 months ended June 30, 1941.

That is the figure that the various people who were interested and who received the published statement saw. That figure was increased; that total figure, broken down as to maintenance and operations, was increased by 10 [fol. 6773] percent because of a study and analysis that we make currently and day in and day out as to what is happening to wage rates and material cost and material prices.

Q. If I were to tell you, Mr. Coffman, that the operations expense shown in the amount of $2,902,353, included a single item of an amount in excess of $1,000,000, could you tell me what that item was?

A. Not at the moment.

Q. You would not have the slightest idea?

A. Not at the moment, because, as I have said, I did not study the breakdown, so I do not know how I can answer.

The figure I had before me was the only figure that was available to the investing public.

Q. Well, that is not quite so, is it, Mr. Coffman? The stockholder has a right to examine the books and records of the company, hasn't he, at reasonable hours?

A. Well, on occasions, there is usually a certain time set but for all practical matters he does not have the chance to have access to the books, because people just cannot take trips to Kansas City and spend two days poring over the books.

Q. Well, they can write to the Federal Power Commission, can't they, concerning the subject matter filed as public record in their annual reports?

[fol. 6774] A. They can do that.

Q. Well, the information is available to them if they want to go and get it, isn't that right?

A. Or part of it, anyway, if not all of it.

Q. Well, all this information about the detail items of maintenance and operations expense was available to you if you had wanted to get it. Isn't that correct?

A. I could have gotten a good portion of it, but the time which I had to spend on this study would not permit the number of weeks it would have taken.

Q. Well, let me be clear about one thing. Is it your testimony that all things purchased by the amount of $2,902,353 of "Operations" expense for the year ended June 30, 1941, will increase 10 percent by reason of materials and wage costs increases?

A. Are you referring to the matter generally or are you confining it as applied to Panhandle Eastern?

Q. I am speaking of Panhandle Eastern and particularly of the figure shown in the Chart No. 29.

A. Well, what I am saying on that, then, is that the operations and maintenance charges, in my opinion, can reasonably be expected to be 10 percent higher for the coming 12 months than they were in the last.

Q. Do you mean per unit of sales or in the aggregate?

A. I am talking altogether in terms of aggregate dol- [fol. 6775] lars as shown on the chart.

Q. Regardless of the amount of revenues expected to be derived?

A. Revenues haven't anything to do with this particular item, as such. If you do more business or if you service more communities, the likelihood is that there will be more operations and maintenance, naturally, but so far as this individual item is concerned right now, that is a separate division.

Q. In other words, this increase of 10 percent which you show in your Chart No. 29 of Exhibit 65 does not include anything for increased business, for maintenance and operations to take care of increased business, but simply reflects a 10 percent rise in materials and labor costs?

A. No, it takes in other factors, also. I refer again to the figures that I used as an illustration on operations. [Betwen] the 12 months ended June 30, 1940 and the 12 months ended June 30, 1941, as I just answered you, during those two periods there was an increase in gross revenue and more business done. At the same time, as I have shown, there was some $400,000-odd increase in operations expense alone.

That was approximately a 20-percent increase.

[fol. 6776] Q. Well, then, this increase of 10 percent is going to take care of the increased business requirements for the year ended June 30, 1942?

A. Will you read the question?

Trial Examiner: Read the question.

(The pending question, as above recorded, was read by the reporter.)

The Witness: I would say that most of it is related to the increase that can be expected from the price trends and wage trends and that if there is any over that can be attributed to increase in business, but so far as your question is concerned, I did not there make a break down as between how much is increased business and how much is attributable to rise in wage rates and material cost.

Mr. Wheat: I am sorry, I didn't hear that last part. Did you say you did not make a break down?

The Witness: I said that I did not segregate. I didn't use that word. But I am saying that I did not segregate in the increase of the difference between $3,196,797 and $3,516,000, the amount that would be for 10 percent increase in wages, 10 percent increase in material costs and other factors. In other words, looking at the over all amount, I said that 10 percent was a reasonable expectancy as an increase when compared with the actual 12 months ended June 30, 1941.

[fol. 6777] By Mr. Littman:

Q. For how far into the future after June 30, 1941?

A. I have already explained so long as there is no major change in conditions.

Q. Well, that might hold good for one day, then, might it not?

A. Well, it might hold good for one year, but so far as the approach is concerned, it will hold good just as long as the classical theory of forming a rate basis and the rate of return will hold good.

Q. Well, now, seven months have elapsed since June 30, 1941, will this amount which you set for the Chart 29 in the amount of $3,516,000 for operations and maintenance hold good for these past seven months?

A. I don't know. I haven't seen the statement as of December 31, 1941, so I can't say. I haven't made the comparison, but it would not be a difficult thing to do.

Q. Well, Mr. Coffman, you based your increase and your determination of the entire projected amount upon your general knowledge. Now, why can't you apply your general knowledge of conditions to the item of maintenance and operation and look back over seven months and tell us whether your prediction was proper in the light of what has transpired?

A. Well, so far, generally, as the economic conditions [fol. 6778] are concerned with material costs and wage rates, I think that they have more than been borne out. I think they have been higher on the average than 10 percent. And as I say, if I were to make this study today exactly on the same basis I made it some seven or eight months ago, or whatever time it was, I would make the allowance higher than 10 percent in view of my general knowledge as it is today.

Q. Now, you can't tell us what proportion of this investment of $319,000 in maintenance and operation expenses is strictly attributable to increases in the cost of materials and labor and that which is attributable to increased business, can you?

A. No. And I would go further, Mr. Littman, and say that in my approach I was trying to get some method which would be comparatively simple and, unless some figure as reported can be stated to be wrong, that there might come from this a quick method to get at some rates available for the purpose of this proceeding. Now, if I am going to have to follow on an approach which will become as laborious and as costly as used to determine reproduction cost new and the others substituted yesterday that were originally made on the old classical theory, then it seems to me that you handicap the whole approach.

Q. Well, does the determination of the amount of op- [fol. 6779] erations expenses have anything to do with reproduction cost. A. Operations and expenses?

Q. Operation expenses.

What does the reproduction cost there have to do with operations expenses?

A. I wasn't saying anything about that, Mr. Littman, so far as my approach was concerned. I was merely citing by comparison the difficulties that you get into if you carry all of these studies to such minute detail that it takes the better part of a year or longer to complete them and the cost is run into tremendous sums of money. For my purpose, I was trying to find some method which appeared to me to be reasonable, wherein you could get some figures for this purpose. Now, if the Commission makes an investigation and finds that one of these figures is improper, I would be perfectly willing to take the proper figure, but until that is straightened, I have nothing else to accept than the figures that are reported to the public.

Q. Plus 10 percent.

A. Well, I made that allowance because of the reasons I have already given, yes.

Q. Now, you have indicated that most of this 10 percent is for the increase in wages and material costs rather than increases in the amount of labor and the amount of material. Is that correct?

[fol. 6780] A. I don't recall that I said any such thing.

Q. Well, what is the fact?

A. I said that what I had was a figure of $3,196,797 and in studying the external conditions, knowing the general trends and so on, it seemed reasonable to me that a figure would increase at least by 10 percent, so I multiplied such figure by 10 percent and added on the additional amount to get the figure. That is the fact and there is no other explanation to it.

Q. Can you state the amount of wages paid by the company in the year ended June 30, 1941?

A. Well, I have really answered that, haven't I? I have told you I have no break down, so how can I tell you what the wages are that are involved in this?

Q. Did you assume that the cost of gas purchased by Panhandle Eastern Pipe Line Company from its vendors was going to increase per unit after June 30, 1941?

A. You are talking now purely about the purchase price?

Q. Yes.

A. Well, in so far as they had contractual arrangements with their various vendors, it certainly wouldn't change until the contract so stipulated. If they had to

make some new contracts, that portion of the gas might cost them a little more. They don't just go out and buy [fol. 6781] that without some contractual arrangement, of course.

Q. Do you know how much of it is contracted for and how much of it is not contracted for?

A. No, I didn't make a detailed study of that.

Q. Do you know anything about the terms of the gas contracts?

A. No, I did not review those.

Q. Well, without knowing something about the contracts and the dates when they expire and the conditions under which Panhandle Eastern Pipe Lines purchases its gas, you can't tell whether the cost per M.c.f. of gas purchased is going to increase after June 30, 1941, or is going to remain the same or is going to be less, can you?

A. As to the specific amount, no, but you are working in a variable time element which I do not think is to be involved. In no case throughout the approach am I saying that this study will last any longer than any other approach. If conditions change or contractual arrangements change, a new set of factors must be considered. I say we make the study and I shall proceed to do it. If a change is to occur in any major factor, then, obviously, a new study would be necessary.

Q. Well, omit the time element from my question and answer as of the day, June 30, 1941.

A. Is that an additional question?

[fol. 6782] Mr. Wheat: Have you completed your question?

Mr. Littman: Perhaps I better reframe it in the light of the witness' answer to my previous question.

By Mr. Littman:

Q. You say that you cannot state what period of time into the future after June 30, 1941, your "projected" figures of operations and maintenance shown in Chart No. 29 of Exhibit 65 will go? Can you?

A. Well, I didn't say exactly that. I said that these figures would hold good if they were found to be proper figures, that is, for what they represent if they are found to be proper they will hold until there are any major

changes in any of the important factors relating to this approach. At that time it would be necessary to reappraise the situation and come to new conclusions and I don't see that that is any different than would be the case under the classical approach. I mean if a major factor changed there, you either have to make a new study or find that the results are no longer in keeping with the original opinion.

Q. Well, has any major change occurred since June 30, 1941, that would change your 10 percent increase?

A. As I say, the trends are continuing to go up and if they continue on, further allowances will have to be made. [fol. 6783] If the management doesn't make them, they are going to be stuck with them just the same as anyone else.

Q. I am talking about the seven months that had expired June 30, 1941.

A. Generally, prices have gone up and wages have gone up more than 10 percent, yes.

Q. Then you want to change this projected figure and increase it some more?

A. Not at this point. I have made the approach and at the moment, I stick with it, but I say this, that if the trends continue to go up, further allowances are going to have to be made because they are actually going to have to be met.

Q. So far, down to date, you stick by your projected estimate of $3,516,000 as the "dollars needed by Panhandle Eastern Pipe Line Company for operations and maintenance"?

A. That is right, and I will stick with that until such time as a reappraisal of all these factors indicates that 10 percent is not sufficient, that you will have to have more and other allowances for increases will have to be made in the other figures I have used, yes.

Q. I take it from your testimony, Mr. Coffman, that in order to make an estimate of operations and maintenance expenses for the future, you don't have to know anything about the amount of sales or the amount of pur- [fol. 6784] chases or the amount of materials or the detailed accounts in order to make a proper estimate?

A. Why I haven't said that, and I haven't implied that.

Q. All right, let's go through these. Can you tell us what the sales of Panhandle Eastern are going to be on and after June 30, 1941, as estimated by you or as estimated by anyone else?

A. I have got the figure right in the exhibit here, what the gross revenue is going to have to be on the basis of calculations I have made. So long as the conditions generally exist under which I made this study, I still say that those figures are the reasonable figures, based upon this approach.

Q. Is the amount of $15,520,855, which is shown in your chart No. 37, as "Total Dollars Needed", the amount of revenue which you expect Panhandle Eastern to have in the future?

A. I say that under conditions which existed at the time this study was made, allowing for increases that are specifically stated in the various amounts, allowing for what will be necessary in the way of current capital requirements executed on the basis as clearly stated in this report, that this company would have to have gross revenues of $15,459,545.

[fol. 6785] Q. How many M. c. f.'s are contemplated by that figure?

A. I don't know. I haven't worked it out on a unit basis.

Q. Well, what I would like to know is how many units you expect to sell and how many units you considered would be sold in arriving at this estimate. Without this number of units, Mr. Coffman, you appreciate that it would be practically impossible to put this exhibit to any use.

A. There is another angle, also, that has to be considered besides that, it seems to me, Mr. Littman.

Q. Well, suppose you answer my question first and then we will talk about the other angle that you want to talk about.

A. That is exactly what I am going to do, if you will permit me. If you will make the assumption that as of today the M. c. f.'s being sold were to remain static, but because of external trends the various costs for operations, maintenance, and taxes and so forth, which I have enumerated, arrived or reached the figures which I have, even though there had been no increase in M. c. f.'s, I would still say that the company under those conditions I-

have just outlined, had to have $15,459,545; so that what you have to have is not only the M. c. f.'s, but you have to have the trend of the times and the cost of doing business. I think that, if you will take the example I have given, [fol. 6786] answers your question.

I have said here that these estimates which I have made were reasonable and when you accumulate those various items, you arrive at $15,459,545.

Q. Well, do you assume that the number of M. c. f.'s sold by Panhandle Eastern will remain static?

A. I don't think they will, no. I think this is still a growing industry and I think this particular company is a growing company.

Q. And you think that the sales are going to increase?

A. I think they will.

Q. Now, am I correct in understanding, then, that this amount of operations and maintenance of $3,516,000 shown in Chart No. 29, is the amount which would be required in order to produce the $15,520,855 of revenue shown in Chart No. 37?

A. I don't know whether I get your question correctly, but so far as the relationship of $3,516,000 for operations and maintenance, as I have projected the figure, is concerned in comparison with the $15,549,545, obviously, they are related because the $3,516,000 is a part of an accumulated total to arrive at the larger figure.

Q. Well, you say they are related, but you don't tell us how they are related. Will or will not Panhandle Eastern Pipe Line Company be required, according to your [fol. 6787] estimate, to spend $3,516,000 in maintenance and operations expenses in order to receive $15,520,855 of revenue? That is Chart 37.

A. Under the study that I have made and the approach used, that is the amount that I believe reasonable under the conditions mentioned for operations and maintenance, yes.

Q. So that your study contemplates, as shown in Chart No. 27, a horizontal 10 percent increase in wages and materials costs required to produce that revenue after June 30, 1941; is that right?

A. I believe I have answered that by the explanation that I gave originally. I merely—

Q. (Interposing) Can't you answer that yes or no?

A. (Continuing) —I increased. I don't know what you mean by "horizontal." The $3,196,797 which was the actual figure, was increased by 10 percent to arrive at $3,516,000. There can't be any other explanation to it, that is it.

Q. Take it or leave it, that is it, that is all there is to it?

A. That is exactly how I got my figure so far as the $3,516,000 is concerned, that is the only explanation I can give you.

Q. Suppose you had estimated the increase to be 20 [fol. 6788] percent by mistake. How would we know or how could we ascertain that you had made a mistake from the explanation that you have made?

A. Well, I would presume that with the experience that the Commission has they must know whether a figure, in the first place, looks reasonable or unreasonable. In addition to that, I had assumed the Commission was making rather elaborate studies as to all these items and arriving at a conclusion as to whether the figure was proper, whether the accounting for the figure had been proper and so forth.

Q. It looks like we are going to have to go through the figures by the classical method, after all, in order to test whether your very general estimate of an additional 10 percent is right or wrong. Is that correct?

A. Well, that isn't the way my mind works. It may be true, but I don't believe it.

Q. Well, in order to check whether you are right or not, what do we have to do?

A. Well, so far as the operations and maintenance are concerned, if you want to find out whether that is right, that is just one set, one group of accounts that are included in those classified cases. They can be analyzed.

Q. Yes, but how about this 10 percent increase that you applied?

[fol. 6789] A. Well, economists and all people interested in what is happening to the economic factors in the country study the trends. I should suppose that the Commission is doing the same thing, as well as studying the records of the company. I am sure you must be.

Q. Doesn't your 10 percent increase apply to all of the items of operations and maintenance?

A. Well, the 10 percent is applied against the total figure, Mr. Littman, and how can I break it down in detail more than I can tell you the individual items when I tell you I didn't have them to work on? It seems to me I get no place answering your questions, because I have to give you the same answer. I have already admitted it a half dozen times. I don't have the details now, I didn't when I made the study, and I can't make them up here.

Q. Well, did you or did you not reflect an increase in the unit cost of gas purchased from vendors in your estimate of operations for the projected period? Can you answer that question or not? You either did or you didn't, you know.

A. Well, no, your question still isn't fair, because you are pinning me down to one item. I didn't have any of the individual items, so I will answer your question as specifically as I can by saying that if such item were in the amount of $3,916,797, and I increased that over all [fol. 6790] figure by 10 percent, in so far as another figure is in there, you could multiply each of the items by 10 percent to get the total or not. But I didn't do it that way; I took one total figure and increased it by 10 percent.

Q. The thing we would like to know is how you did do it. A. Well, I just got through telling you.

Q. And what it contemplates. Does or does not your study contemplate an increase in unit cost of gas purchased, assuming that the cost of gas purchased is in here, and which you don't know, incidently? Assuming that it is in there, will you answer my question, please?

A. I will answer your question as I did before. The $3,196,797 was increased by 10 percent to arrive at my figure and I do not have any break down of details or any individual figures to which I applied individual percentages. I say that it is a reasonable expectation, with conditions as they were when I made this study, that this particular item would increase 10 percent.

Q. Now, I want you to assume that all of this operations expense of $2,902,353 represents gas purchased from vendors. Under that assumption would you have applied a 10 percent increase to it?

A. I wouldn't have applied a 10 percent increase if there had been no wages and materials, because, as I [fol. 6791] have told you, wages and materials increases

were part of the explanation of getting the 10 percent. Now, if there were no wages or materials involved at all, there wouldn't be any 10 percent. If there were any additional contracts for gas written, I could get some idea of an increase in that, I would take it into consideration, if I had those detailed facts.

Q. Now, you have to have those detailed facts, don't you, before you could do anything with such a figure?

A. No, I don't have to, because I have already done this and I have it right here and I didn't have any of them.

Q. Now, assuming that $2,000,000 of this operations expense, which totals $2,902,000, were gas purchased expenses, what would you do in those circumstances? Would you still apply a 10 percent increase to get your projected figure or wouldn't it make any difference?

A. To the extent that there was no labor and materials involved in the particular item, there would be an adjustment for that amount. But taking the figure your over all—

Q. (Interposing) How would you adjust it?

A. Well, depending upon what facts I could get, but I say that individual figures, for example, in a total, one you might increase by one figure and another figure by another, [fol. 6792] and if you come out with an average, it would be 10 percent; just as I have studied yield rates on securities, bonds are 2.74, preferred stock 8.45 and common stocks 12. If you average that, you get 7.99. Well, this 10 percent—

Q. (Interposing) We will come to that.

A. I am just using that as an illustration to come to this, so that when you get through you get a 10 percent over all increase. That is the method that was used here.

Q. Well, assuming that there was one million dollars worth of gas purchased expenses, and I am speaking now of amounts paid to gas vendors by Panhandle Eastern included in this $2,902,353 figure of operations for the year ended June 30, 1941, what would you do in that event?

A. I don't know, Mr. Littman. I come right back to my original answer. I increased a sum total figure of $3,196,797 by 10 percent.

Q. Now, how do you know that is right without knowing how much labor is in here and how much gas purchased is in here?

A. I don't really know that it is right, but it was my very best judgment under all the factors I considered and made at the time, just the same as anyone else uses his judgment on everything that he is working with. I don't know. Time will prove whether it is right or not.

[fol. 6793] Q. But your judgment is not any better than what you know about these things, Mr. Coffman. Now, you told me a minute ago that you would want to know how much gas is included in here and that you would want to make adjustments accordingly, is that right?

A. I say, if I had all of those figures, it is like every other study in that it would be just that much more material to work with.

Q. And so much better an estimate?

A. It might be, but, after I got through, I might come out with 10 percent.

Q. You would be lucky if you did, wouldn't you?

A. No, I do not think I would be too lucky, no.

Q. Do you know whether any delay rental expenses are included in the amount of $2,902,353 of operations?

A. No, I do not.

Q. It is a fact, is it not, Mr. Coffman, as you know in your Exhibit 65, that the operating ratio of this company has declined consistently through the years.

Do you recall the chart where you show that conclusion? I believe it is Chart No. 8 of Exhibit 65.

A. Yes, Chart No. 8. The operating ratio of Panhandle, before taxes, has shown a general decline from 1934 through 1937.

During 1937 there was an increase and then, beginning [fol. 6794] in 1938, it started to decline again. After taxes, however, the operating ratio showed a decline until 1937 and, since that time, has shown a rather marked increase.

Q. And the operating ratio, as indicated by your Chart No. 8 for Panhandle Eastern Pipe Line Company, is substantially below that of the average of other pipe-line companies, is that correct?

A. Yes, that is correct.

Q. And do I correctly understand you to mean by the term "Operating Ratio", the relationship between revenues and expenses?

A. Yes, sir.

Q. That is the percent of gross revenue consumed by operating expenses. Is that a correct definition?

A. That is correct.

* * * * * * * *

By Mr. Littman:

Q. Will you turn to Chart No. 10 of Exhibit 65. On this chart you show in graphic form, the "Percent earned on invested capital of Panhandle based upon capital structure".

[fol. 6795] Will you state the percent earned by Panhandle Eastern on its invested capital as defined in this chart for each of the years 1937 to 1940, inclusive?

A. As shown in table for Chart No. 10, Exhibit 65, the percent earned on invested capital for each of the years 1934-1940, both inclusive, are as follows:

2.24 percent; 3.50 percent; 6.05 percent; 8.78 percent; 7.77 percent; 9.57 percent; 9.62 percent; and the average for those years was 7.11 percent.

Q. Now, will you please turn to Chart No. 11 of Exhibit 65 entitled, "Percent earned on invested capital of Panhandle based upon net property, intangibles and working capital."

Will you state the percent earned by Panhandle Eastern on its invested capital, as defined in this chart, for each of the years 1937 to 1940, inclusive?

A. In table for Chart No. 11 in Exhibit 65, the percent earned on invested capital for the years 1937-1940, both inclusive, were as follows:

8.76 percent; 7.75 percent; 9.49 percent; and 9.54 percent.

Q. What is your opinion as to the reasonableness of the percents earned by Panhandle Eastern on its invested capital which you have just read into the record for each of the years 1939 and 1940?

[fol. 6796] A. Mr. Littman, you cannot consider it, looking at it from the over-all investor's point of view, for any individual year.

To answer your question, I would have to look over a period of years to satisfy myself that, over such years, the

average that you might get would be satisfactory to the investor and I would have to have such figures in order to determine whether or not the figures in the few years you mention were in line with the general average, higher or lower, because, after all, the invested capital was in the company for many years and would continue to be and the investor watches that, not as of a given year, but tries to ascertain how he will fare over the length of life of that investment.

Q. Well, what would you say about the percent earned on invested capital by Panhandle Eastern in 1939 and 1940 in the light of the data which you have for the previous years as shown in your charts Nos. 10 and 11 of Exhibit 65?

A. Well, as the table mentioned shows in the early years, because this company was just then getting underway, so to speak, it was a comparatively new company and its earnings were not large in comparison to invested capital.

The return was very small.

Now, if the investors had thought that making such investment in this company, the return was going to continue on those low levels, I do not believe they could ever have [fol. 6797] been encouraged to make the original investment. They did feel, however, that although there was a period of waiting, perhaps later on, when the corporation got settled in some degree of maturity, its earnings might be better, in which case they would make up in the later years some of the lower returns that they had to suffer in the earlier years and they will look at it on the basis of the average over all to see whether or not, in their opinion, it proved to be a sound investment.

Q. My specific question related to the percent earned on invested capital of Panhandle Eastern in the year 1939 and in the year 1940, which was very close to 9.5 percent in each of those years. Do you think that was reasonable?

A. In view of the past history, I do, Mr. Littman, for the reasons I have just given. The average for the period 1934-1940, both inclusive, as shown in this particular table, is 7.11 percent and, in another connection, with the figures I have already recited, the investor's appraisal of the risk of capital at the same time this study was made varied all

the way from 2.74 percent on down to 12 percent on common stock.

This takes the invested capital as a whole. If you take in the other study, the invested capital as a whole, the figure as we already have it in this record is 7.99 so that it seems to me one must conclude that the two years you [fol. 6798] mention where the figures are 9.5, approximately, for 1939 and 1940 had to be such in order to bring up the average to what would appear to be a reasonable figure so that, so far as those figures are concerned, I do not believe they are unreasonable.

Now, if you should continue a period of years in which they should remain at that same level, when the over-all investor's appraisal of the risk of capital was running 7.99, I would then review the facts but, until such time as you find such average, I say the figures here are not unreasonable.

Q. You mean the figure of 9.5 percent, approximately, earned on invested capital of Panhandle Eastern in the years 1939 and 1940, is, in your opinion, reasonable?

A. That was not quite my answer, Mr. Littman; I said you had to consider a period of years because that is the way the investor looks at the situation.

He is perfectly willing to make an investment in an enterprise knowing there might be a period of waiting for some return but he would not make any investment at all unless he felt at some point along the line the company would settle down on an earnings basis whereby the original investor would begin to get a return.

Now, in the period mentioned, 1934-1940, both inclusive the average percent earned on invested capital as shown [fol. 6799] in table for Chart No. 11 of Exhibit 65 is 7.11 and at the time this study was being made, our study of the investor's appraisal of the risk of capital showed that to sell securities of this general type in the market, the investor required 7.99 percent.

Therefore, I say that, taking a look at the years generally from the investor's point of view, the 9.5 percent approximately, for 1939 and 1940 was not unreasonable because those were necessary to bring the average up to

about what the investor said he would require if he was to finance this particular property.

Q. Is what you have just said true of an investor who first invested some money in this enterprise in 1940? What does he have to make up?

A. Well, the capital is already in the business. The exchange of shares from one stockholder to another has nothing to do with the company.

In other words, whatever gain or loss there is [there] to be considered is made up between the two parties.

Q. In other words, if I were to buy a share of stock in Panhandle Eastern today, you think I would be entitled to require an over-all return of 9.57 percent in order to make up what my vendor of that stock had not earned in the previous years?

A. I say that if you buy a share of stock in this firm [fol. 6800] as of today or as of the date of this study, rather, confining it to stock, our study indicates that you would have to sell that stock on the basis of a 12 percent return and that is based on actual transactions of similar securities in the market as of the date of this study.

Q. Well, of course, here we are speaking of an overall return.

A. The over-all return, as of the same date, was 7.99. You might call it 8 percent in round figures.

Q. Suppose I were to buy, today, bonds, preferred stock and common stock in the precise proportions which would equal this 9½ percent earned on invested capital.

Do you think that I, as a new investor in Panhandle Eastern, would have any right to expect to recover and make up for lesser earnings in earlier years on invested capital?

A. According to my study of the investor's appraisal of the risk of capital, the demand at the date of this study was an over-all 8 percent.

However, your particular illustration points out one very small part of total, namely, shares that you might buy from me or from someone else. There is the further consideration that many of these investors who originally

put money into this situation put it in as an investment. They did not go into it as a speculation.

Therefore, they are not buying and selling these shares [fol. 6801] currently or, for that matter, frequently. They are holding it or retaining it for the purpose that they originally made it so that you have to draw a distinction between what you as an investor might do and what the great majority of the people are doing who put the money originally in it and those people are holding on because they still think, as the situation goes on, that the average of 7.11 will approach 8 percent.

Q. Isn't [you] study, contained in Exhibit 65, predicated upon the proposition that the entire invested capital in Panhandle Eastern is going to be floated on the market as of June 30, 1941, and isn't your capital requirement figure predicated upon the cost of raising that amount of capital?

A. It is predicated upon the basis that as of the date of this study with this company going to need financing, it would have to pay at the over-all rate mentioned.

Q. Now, does that presupposition take into account that these securities are going to be floated on the open market to whomsoever wants to buy them?

A. Well, if the company is to be and continues to be privately financed, that is, publicly financed, I presume that is where the money will come from, the general investor.

Q. Now, that might give you an entirely new set of [fol. 6802] security holders of Panhandle Eastern on this theoretical assumption, might it not?

A. If you brought out a new issue, you might get some old ones, you might get some new ones or they might all be new; I do not know.

You will naturally be trying to tap that capital market where the capital is available and where the investor believes that this is an attractive investment at the price you are attempting to sell it.

Q. Do you think, under those circumstances, that the new investors would have any right to expect or would reasonably expect to recoup past deficiencies in earnings on invested capital?

A. As I say, our study indicates that for an over-all picture, the rate is approximately 8 percent at the time this study was being made.

Q. Eight percent on what? I do not get that 8 percent.

A. Eight percent as the investor's appraisal of the risk of capital. That is the 2.74 for bonds, the 8.45 percent for preferred stocks and the 12 percent for common stock and then working it out for the over-all capital, the rate was 7.99.

That figure has already been mentioned in these hearings, calling it 8 percent in round figures.

Q. If I may interrupt to explain something for the pur-
[fol. 6803] pose of the record? A. Yes.

Q. This 7.99 percent or 8 percent that you have just mentioned is a percent of earnings related to market value of the total outstanding securities, is that right?

A. That is the percent that the prospective investor says he now wants if he is going to put a dollar into this business.

In other words, that is his appraisal of the risk of this business at the time of the study. However, as I tried to point out, the great majority of original investors in this business made their commitment by way of an investment.

That is, with the idea of buying these securities and holding them in contrast to buying them and selling them. Now, if any one or more of those original investors elect, for one reason or another, to sell their securities and they sell to another individual at a price, they naturally will sell at whatever price they can make the sale.

If that involves a loss to them in comparison with what they think they should have had over the period, that is perfectly all right. They took that loss at that time and were willing to do so or they would not have sold.

For the rest of the investors in the company, they are still holding on with the idea that, on the average, when
[fol. 6804] this company goes enough years, instead of having 7.11 percent, they will approach this 8 percent or until conditions so changed that we are not talking in

terms of 8 percent but some other, but as I have shown in this particular investigation as of this date, they were definitely talking of 8 percent over-all.

Q. Now, the fact remains, does it not, Mr. Coffman, that in 1940 Panhandle Eastern earned on its invested capital 9.62 percent, according to Chart No. 10 and 9.54 percent, according to Chart No. 11?

A. That is correct, yes, sir.

Q. And you say that the investor's appraisal of risk, according to your testimony, is 8 percent or slightly below 8 percent?

In other words, Panhandle Eastern Pipe Line Company actually earned something in excess of $1\frac{1}{2}$ percent above what you have termed the investor's own appraisal of the risk, is that right?

A. That is correct, with this added explanation:

That, as the two tables you refer to clearly show and continuing to look at this picture from the investor's point of view; although the figures for percents earned on invested capital were 9.5, approximately, in 1939 and 1940, the investor looks back to earlier years, such as 1934, '35 or '36, where he finds that the return percent earned on [fol. 6805] invested capital was 2.30 percent, 3.50 percent and 6.05 percent which merely indicates a fact that I have been trying to mention all along, that conditions change from time to time. Sometimes conditions are better, sometimes they are worse.

The investor is not going to be unduly excited about any one year so long as he has confidence in the firm. The percent earned may be a little higher one year, lower the other, but he says that if, on the average over a period of years, this matter works out, he is perfectly willing to continue to refinance or newly finance this company whenever they need capital.

Q. Now, is it your opinion that if the return in the early years was low, that it should be compensated for by a higher rate in later years to make up for it?

A. It is my contention—

Q. (Interposing) Can you answer that yes or no, first?

The Witness: Will you read that question?

(Whereupon, the pending question was read by the reporter.)

The Witness: Yes. I say that with this explanation:

That investors will not finance this company unless they are going to see a fair average over the years. Now, to make my answer very specific, if this company has shown, over the years, because of unfortunate results, or some [fol. 6806] other condition a percent earned on invested capital for a number of years of 2.30, as it did show in 1934, I do not think any investors would be willing to put a nickel in this business today.

In other words, the company would not have maintained its credit position and it would be impossible to finance the company.

Now, the reason people have been willing to stay in this company as investors is because they knew the company was new in these early years. They hoped, as it settled down, got more service to the public, that it would begin to earn money, which it did, and when the rate approaches 8 percent, on the average, they would say they were willing to continue to finance this company.

Q. Did you make any investigation, Mr. Coffman, to determine the fundamental and underlying reasons why the return earned on invested capital of Panhandle Eastern was what you term "low" in the early years?

A. I think I know generally why it was. I made no particular investigation because, in this particular situation, an investor merely looks at the result.

You can have all of the reasons you please but the fact remains that the earnings on invested capital was 2.30, that is a fact which you cannot explain so far as the investor is concerned and he would not continue to finance [fol. 6807] the investment unless you can show him the conditions are to be changed favorably.

Q. You are not interested so much in the reasons as you are in the fact the investor did experience what you call "low returns" in the early years and wants to make them up in later years?

A. I say that the investor puts the money in with the idea that he, first, was getting security of principal and an assurance of a reasonable return on that principal and a good many of the securities which he purchases actually are in the nature of a contract to that effect and anything short of that involves some difficulty unless the investor's property is just going to be confiscated, just taken away from him.

Q. Mr. Coffman, do your rate of return figures reflected in Charts No. 36 and No. 37 which produce the dollars called "current capital requirements" for each of those charts reflect the element which you have just discussed, to wit, the element of making up for low returns in the past?

The Witness: Would you read that question, please?

(Whereupon, the pending question was read by the reporter.)

The Witness: I think the two—

By Mr. Littman:

Q. (Interposing) Can you answer that yes or no, first, [fol. 6808] [Mr.] Coffman, and then make your explanation?

A. No. The answer is no as you put the question because, in Charts Nos. 36 and 37, the item which involves the matter of the investor is contained in the two columns, one each on Chart No. 36 and the other on Chart 37 captioned, "Current capital requirements", and there those figures are based upon the principles we have already discussed, namely, the rate of 2.74 for bonds, 8.45 for preferred stock and 12 percent for common stock or the 7.99 percent on the over-all basis.

Q. You then have not fixed rates which will compensate the investor for these past low returns, have you?

A. The—

Q. (Interposing) Have you or have you not? May I have an answer?

A. Yes, certainly I have because I am stating here that, on the average, the investor says he will be content with 8 percent and if the company can approach that over a period of time, conditions remaining about as they were at the date of this study, he says he is perfectly willing to finance this company. Now, the average over the past

years, as a fact, have been 7.11. It is true that they have been increasing.

Q. If the rates earned by a given company in recent years are considered high by its investors, then, to follow [fol. 6809] your theory, the investor should expect lower rates of return in the future years to compensate for the past high rates, isn't that correct?

The Witness: Would you read that question, please?

(Whereupon, the pending question was read by the reporter.)

The Witness: I still answer as I have been in accordance with my study.

By Mr. Littman:

Q. I have not asked you this question before, Mr. Coffman. I mean to say you have not answered it before. I have not even approached this new thought yet.

A. I thought this was a question. Didn't you just ask a question?

Q. I just asked this question but you are telling me you have already explained it. This is an entirely new thing.

A. No, so far as I am concerned, it is not, Mr. Littman. What I was just about to say is that when the investor looks at a given situation, he is not talking about the particular year because he knows because of business cycles and other conditions, some years are good and some are bad.

He will not be disturbed one way or another so long as, on the average, he finds he can get this particular rate he believes to be reasonable. So that a few years may be high. [fol. 6810] He knows that there will be some other years low, because history, from the beginning of time, proves that.

If he can get 8 percent on the average he is not unduly disturbed. Now, if a few years are low, he expects other years to be high to offset it. If a few years have been high, he knows, by the same token, that a few years will be low which will offset it. He is not disturbed either way on that if, on the average, he can get this figure.

Q. What, in your opinion, is the highest percent that one might reasonably expect Panhandle Eastern to earn on its invested capital in the years 1939 and 1940?

A. So far as the investors are concerned, the percents they did earn were in line because if the investors said that an average of 8 percent was the risk, then the average for these preceding years, as a whole, showing only 7.11 percent, were still not giving him on the average what he believed he required.

Q. Well, Mr. Coffman, I take it from your answer that, in your opinion, the investors of Panhandle Eastern Pipe Line Company had a right to reasonably expect Panhandle Eastern, to earn on its invested capital in 1939 and in 1940 the amounts which it did earn, approximately 9½ percent. Can you answer that yes or no?

A. No, I cannot answer it yes or no because I do not [fol. 6811] know about some of the words. I would like to state this: You say, "their right" to do something. Well, "right", to me, for the most part, is a matter of law. "What your rights are."

I say that the investor said that if he were to put money in this business, he would require, over a period, a return of 8 percent or he did not want to put his money in this business. Somebody else could, but he did not want to.

That is the matter of what he requires. I am not talking about right. I believe those are matters of law, for the most part.

Q. Let me put it this way; that, in your opinion, the investors of Panhandle Eastern might reasonably have expected Panhandle Eastern to earn on its invested capital in 1939 and 1940 the return of 9.5 percent which was, in fact, earned?

A. In view of the history of the company to this date, I think they could reasonably have expected that condition, yes.

Q. Now, Mr. Coffman, did you testify before a Special Master in the United States District Court for the District of Delaware in a suit in which David Young III, was plaintiff and Columbia Gas and Oil Company was one of the defendants?

[fol. 6812] A. Yes, I did.

Q. Can you state approximately when you testified in that proceeding?

A. I am not certain. As I recall it, that was along in the fall, I would say, of 1939, fall or winter of 1939.

Q. Mr. Coffman, I will read a question which appears on Page 3434 of the transcript of that proceeding. Before reading that, I will hand you a copy of the Defendant's Exhibit No. 33 in that proceeding.

Mr. Wheat: Can you identify the proceeding for the record? Would you like to, Mr. Littman, more closely?

Mr. Littman: Well, it is the proceeding which is referred to in Exhibit 145 on Page 12 in the middle of the paragraph: David Young III, Plaintiff, commenced an action in the United States District Court for the District of Delaware against Columbia Gas and Columbia Oil as Defendants.

That is the proceeding, is it not?

The Witness: Yes, that is right.

By Mr. Littman:

Q. I hand you a copy of Defendant's Exhibit No. 33 for purposes of assisting you to follow the testimony and refresh your recollection. But first, am I correct in understanding that you prepared Defendant's Exhibit No. 33, the photostatic copy of which I have just handed you, sub- [fol. 6813] ject to your check of details?

A. I do not remember the number but this material I prepared.

Q. Yes.

Now, I will read from Page 3434 of a copy of the transcript:

"Q. What significance, if any, do you attach to the right-hand column in which these percents on invested capital are set forth and to the tabulation which you have submitted to it and which is to be inserted in your book of exhibits in connection with Chart No. 16?

"A. The Panhandle Eastern Pipe Line Company is a public service company subject to regulation, and I made the tabulation in the right-hand part of the chart showing return on invested capital and, operating from the past

history during the years 1934 through 1938, what the company had averaged in earnings in terms of return on invested capital, and I found that the 1938 total income figure indicated a return slightly under 8 percent. The 1937 figure was slightly in excess of 8½ percent and my projected figure, depending upon which calculation you use for invested capital, was 8.34 percent if you talk of invested capital in terms of funded debt, preferred stock and common stock and surplus, and 8.41 percent if you describe invested capital on the basis of the property account.'

[fol. 6814] "I made that tabulation merely to familiarize myself with the comparison of the projected earnings with past experience on the one hand, and considerations of reasonable return on invested capital on the other, and it seemed to me from experience in rate cases, and more particularly a recent experience of the Natural Gas Pipe Line Company of America that the amount of projected income was about as high a return on invested capital as one might reasonably expect. Anything higher than that, it would seem to me, would be an invitation for some investigation or trouble of some kind or other with the various Commissions."

Now, did you make that answer to that question in the proceeding to which we have just referred, Mr. Coffman?

A. Well, if the record says that is what I said, I admit I said it.

Q. What about your recollection? Is that your best recollection of what you said?

A. Generally, I think so. I mean if you are reading correctly, why, I accept it that I did say it.

Q. Well, subject to your check. You may, of course, make any correction to this that you may find but this is your recollection at this time of what you said?

A. That sounds substantially correct but I mean just technically, I say if it is as you read it, I said it.

Q. What was the projected figure that you were re- [fol. 6815] ferring to in the answer that I quoted from your testimony?

A. You said Exhibit 16, was that right, or Chart 16, I mean.

Q. Chart 16 of Defendant's Exhibit 33. What I want, Mr. Coffman, is the projected income figure to which you referred in that answer which I read from your testimony in the Young III case?

A. The projected total income figure was $4,715,000.

Q. I meant to have you state the projected figure in percent. It was 8.34 percent, was it not?

A. If the net operating income is based on the percentage of capital account, the figure "percent earned on invested capital" was 8.34 percent and if the net operating income was based on "percentage of invested capital", the figure was 8.41 percent.

Q. I so understood your testimony. However, the projected figure of 8.34 percent earned on invested capital will appear in the next succeeding few questions and answers of your testimony.

Now, I will continue reading without any interruption from the transcript. Nothing appears between these questions or answers, Mr. Coffman.

By the way, what I have read occurred on direct examination, did it not, or don't you recall?

[fol. 6816] A. I do not recall, Mr. Littman.

Q. Mr. Payer was one of the attorneys that cross-examined you, was he not?

A. That is correct, yes.

Q. He came into the record at this one point, to clear up something.

"Mr. Payer: When you said 'amount of return', what amount did you have in mind?

"The Witness: You mean return on invested capital?

"Mr. Payer: Yes.

"The Witness: I did not have any particular figure in mind. It just seemed to me that if it got much above 8 percent for a period of time that such percentage return on invested capital might be an invitation for investigation.

"Q. Now, that projected figure of net income before charges other than depreciation and depletion and those that go to operating expenses, is less than the actual income

before charges for the 12 months ended September 30, 1939, is it not?

"A. Would you repeat that?

"(Last question repeated as reporter.)

"A. I believe that the statement that shows the 12 months' figures ending September 30, 1939, are somewhat higher than the projected figure which I show in this chart, No. 16.

[fol. 6817] "Q. Now then, do you justify the use of a projected income figure lower than the actual income before charges during the most recent period for which figures are available?

"A. As I think I said the other day in connection with part of my testimony, I am not attempting in this study to project the income for the next year, which, as a matter of fact, would be the full year 1939. What I am attempting to do in this study is project the income which a willing buyer could reasonably expect on the average after a reasonable period of time, and I do not believe that a willing buyer could reasonably expect to find peak earnings year after year. In other words, there will be some good years and some bad years, and I felt that my projected figure here was a reasonable average over a reasonable number of years in the future.

"Q. In arriving at that conclusion, what consideration, if any did you give to the rate of return on your projected earnings as related to the rate of return in 1937, or the rate of return on the current income for the 12 months ending September 30, 1939?

"A. I took into consideration all the information that was available in regard to total income for the preceding period, covering 1934 through 1938, both in terms of aggregate dollars and return on investment.

[fol. 6818] "So far as the September 30th figures were concerned, this part of my study had been completed before they were available. Actually when they came to my attention, I noted that the figures, as I recall it, for the 12 months ended September 30, 1939, showed something in excess of 9½ percent return on investment, and, therefore, I did not go back and revise my figure because I felt that over a reasonable period in the future such return

on the investment would be above the line of what was considered reasonable in view of cases on the subject, more especially the recent case on the Natural Gas Pipe Line Company of America, which is a very comparable Pipe Line Company."

Now, to the best of your recollection, did you make those answers to those questions in the proceeding of David Young III as Plaintiff, versus Columbia Gas and Oil?

A. Yes, as my recollection goes and if it has been read as it is in the record, I admit having said that.

Q. Mr. Coffman, what other cases or proceedings have you testified in beside the Young case and, of course, the instant case and the Hope case, the latter case having been heard by this Commission?

A. Before this Commission, you said?

Q. I was merely stating that the Hope case had been tried before this Commission.

A. Yes.

[fol. 6819] Q. And I want you to exclude that from the list of cases in which you have testified.

A. In regard to matters similar to this, you mean, or in any matters? I mean do you want the whole list of items where I testified or just in regard to public utilities or what?

Q. Not knowing much about the facts, I do not know whether to ask for all or just those which are rate matters or not. Can you give us an idea how many cases you have testified in first so that we can know?

A. Before this Commission, for example, I have testified in the last two years in the Colorado Interstate case, the East Ohio Gas Company case, in addition to the Hope which you mentioned and excluded.

I have testified in the David Young suit. I testified in a suit, the full name of which I cannot give you, but it was against the General Motors Corporation regarding their management bonus plan.

There have been a fair number, Mr. Littman. I could go on and enumerate some more. I testified before the Board of Tax Appeals and before the Civil Aeronautics Authority.

Q. What other Commissions?

A. The Treasury Department, the Internal Revenue Department in cases involving tax questions before they were taken to the Board, if they were taken there.

[fol. 6820] Q. What other rate cases have you testified in?

A. The only rate cases I have testified in are the ones I enumerated; Hope, ~~Colorado Interstate,~~ East Ohio, Panhandle Eastern and the Pennsylvania Power and Light Company.

Q. Now, the Pennsylvania Power and Light Company proceeding was had before the Pennsylvania Commission, was it not?

A. That is correct, yes, sir.

Q. You do not have any recollection of any others at this time?

A. Involving rates?

Q. Yes.

A. I believe that is all of them.

Q. Well, if you recall any others later, you will advise us, will you not?

A. I can check that up this noon, I think.

Q. Have you been cross-examined on your testimony given before the Pennsylvania Commission in the Pennsylvania Power and Light Company case?

A. Yes, I was cross-examined and relieved with the understanding I might be recalled but, to date, I have not been.

Q. When did you complete your cross-examination before that Commission?

[fol. 6821] A. Well, it was at the same time the direct testimony was given. I do not recall now just what date that was. It has been some three months, I think, two or three months ago.

Q. I see. We were specifically inquiring whether you had been recalled since that first day or two that you testified there?

A. No.

Q. Will you please turn to Chart No. 14 of Exhibit 65. Yesterday, we were discussing the subject of invested capital of Panhandle Eastern Pipe Line Company as of June 30, 1941.

I asked you to substitute for the net working capital figure shown on this chart of $4,661,875 the amount of working capital estimated by Mr. Sperry in the amount of $1,500,000.

Do you remember that?

A. Yes, I do.

Q. Now, the invested capital computed in that manner amounted to $58,054,161, did it not? That is, rounded out, to $58,054,000?

A. Yes.

Q. That will be close enough for our purposes.

Now, in this chart, you show the percent earned on invested capital, that is, on Chart No. 14, which is determined [fol. 6822] by relating the net operating income before and after taxes to the total amount of invested capital of $61,216,031, is that correct?

A. Yes, sir.

Q. And the amount that you show is 9½ percent earned on invested capital before taxes, I mean—

A. (Interposing) That is based on the 1940 rates.

Q. Based on the 1940 tax rates?

A. That is right.

Q. And 7.86 percent based on the 1941 tax rates?

A. 7.86 percent, yes, sir.

Q. Now, this 7.86 figure was determined by applying the 1941 tax rate to the entire year ended June 30, 1941. Is that correct?

A. Yes, that is correct, the 12-months' figure.

Q. In other words, you did not apply—I want to be perfectly clear about this—you did not apply the 1940 tax rate to the last six months of 1940 and the 1941 tax rate to the first six months of 1941, did you, in arriving at this 7.86 percent?

A. No. The purpose of this study was to get a better idea of what the effect of the increasing tax rates were going to have on the business so I kept a static figure.

In other words, if they earned $5,814,000 which was a known fact, at the 1940 rates, the tax was so much. Using [fol. 6823] that same figure as a constant, if the 1941 rates had been in effect, then the net operating income would have been approximately $1,000,000 less.

In other words, I merely wanted to show what the effect of the increased tax rate was going to have upon this company's net operating income.

* * * * * * * * *

[fol. 6824] Paul B. Coffman resumed the stand, and having been previously duly sworn, testified further as follows:

Cross-Examination (Resumed)

By Mr. Littman:

Q. Mr. Coffman, I requested you to make a calculation over the noon recess in connection with Chart No. 14 of Exhibit 65. Have you made the calculation?

A. Yes.

Q. Will you please state what it shows?

A. Adjusting Chart No. 14, Exhibit 65, so that the total invested capital as of June 30, 1941, would be composed of net property of $54,690,591, intangibles net of $1,863,565 and allowing your assumed figure for net working capital of $1,500,000 gives a total assumed invested capital of $58,054,156. Using that figure as a base and making the same calculations, to-wit, that I have actually made on Chart 14, the percent earned on the $58,054,156 before making an adjustment for the 1940 tax rates would be 10.02 percent and after making adjustment would be 8.29 percent in contrast to the 9.50 percent and the 7.86 percent [fol. 6825] shown in the Chart, respectively.

Mr. Wheat: Will you give me those figures again please?

The Witness: 10.02 percent.

Mr. Wheat: Thanks.

By Mr. Littman:

Q. Yesterday I requested you to make a calculation for the purpose of determining what your annual provision for depletion and amortization of $2,551,034 would be if computed on a 6½ percent sinking fund basis instead of the straight line basis. Have you made that calculation?

A. Yes, sir, I have.

Q. And what would it amount to?

A. It would be at 6 and ½ percent for 25 years life annual payment of $1,083,008.21.

Q. Is my understanding correct that the amortization base used in connection with the figure of $1,083,008, the invested capital figure of $63,775,839, which is shown in Chart 27 of Exhibit 65?

A. Yes, sir.

Q. Will you please refer to Chart No. 37 Exhibit 65? You have testified that the amount of $5,064,821 shown on this chart as "Current Capital Requirements" represented a fair return to investors of Panhandle Eastern for the year 1940, have you not?

[fol. 6826] A. I don't believe I said that, no. What I said was that the $5,064,821 was the amount required in order to maintain the credit position of this company that is required by the investors.

Q. Well, isn't that the amount to which you refer in the caption of Chart No. 37 as "A Fair Return to Investors"?

A. Yes, that is the amount, all of which is attributable to the investors' equity in this business or their investment, if you want to particularize.

Q. In other words, if I correctly understand you, this amount of $5,064,821 represents in your opinion a fair return to the investors of Panhandle Eastern Pipe Line Company, as of June 30, 1941; is that right?

A. Well, it is a little more than that. I not only say that it is a fair return, I say that in the conditions existent in the capital markets at the time of the study that that is what they required; not only that it is fair, I say that they required it. I merely want to make my point clear that I am going that far. I am not just saying it is fair, but I am going beyond that.

Q. Well, you are merely emphasizing the use of your term "fair return", are you not?

A. Well, maybe you understand the language one way and I understand it another. I am trying to point out throughout the study that if the investors are to be kept [fol. 6827] in a position where they are willing to invest money in this business, the returns which I use to arrive at this figure of $5,064,821 have to be met under the conditions then existent or the capital is not forth coming to this business, at least from the public.

Q. Well, at any rate, it is the $5,064,821 figure, to which you are now referring?

A. That is correct.

Q. My understanding of your testimony was that this amount, if earned by Panhandle Eastern Pipe Line Company in the year 1941, would have constituted a "fair return to investors" for that year.

A. I am saying more than that, Mr. Liftman. I don't recall that I ever said for 1941 at all. If I did, it is in the record, but I don't believe I said it. What I said was—

Q. (Interposing) For 1940.

A. Well, or for 1940. What I said was that that amount of earnings would have to be made so long as conditions in the capital market remained as they were at that time. Now, that may be for 1940, it may be for 1941, it may be for a shorter time or for a longer time. I would have to make the study to find out. As of that time, that is what the capital market said.

Q. As of what time?

[fol. 6828] A. As of the time I made the study.

Q. When was that?

A. It was in the late summer, let us say, of 1941.

Q. Do you know whether the current capital requirements for the year 1940 would have been higher or lower than that shown in Chart No. 37?

A. No, I don't believe I can give you that figure.

Q. Well, I didn't ask you for any particular figure. I wanted you to state whether in your opinion the amount of "current capital requirements" for the year 1940 would have been smaller or larger than that shown in your Chart No. 37.

A. I don't know; I don't have that particular analysis here.

Q. Did you make such an analysis?

A. No.

Q. Will you please refer to Chart No. 36? I am not sure that you show the "Current Capital Requirements" which is referred to in the caption of that chart as "A Fair Return to Investors," in the amount of $4,993,511, do you?

A. Yes, sir.

Q. Am I correct in understanding your testimony to be that that figure was, also, predicated upon market con-

ditions as they existed as of the date when you made this study?

A. Yes, with the added qualification that the entire [fol. 6829] calculation was based upon refinancing the preferred stock.

Q. I so understand.

A. Yes.

Q. And your caption of Chart No. 36 so indicates, does it not?

A. Yes.

Q. Would you say that this sum of $4,993,511 would be applicable to the year 1940 or don't you know?

A. I don't know, I confine this figure to the date of this study, that is the best I can do on that.

Q. And you can not state from your understanding of general market conditions whether it would be higher or lower?

A. Well, speaking very generally, taking securities as a whole, I would say that in 1940 the likelihood was that the amount required percentagewise, not dollarwise, because I can't give you that without computing it, would have been somewhat lower than in 1941. When I say "percentagewise," I am now referring to that 2.74 for bonds, the 8.40 for preferred and 12 percent for common stock.

Q. At any rate, may we agree generally on this, that you, from your general knowledge of conditions as they existed in 1940, would not expect the current capital requirements of $4,993,511, shown in your Chart No. 37, to be materially different, either up or down?

A. I wouldn't suppose it would be materially different, [fol. 6830] but I couldn't be exact, obviously, until I could make the calculations on a comparable basis.

Q. I don't remember whether your exhibit shows the net operating revenues of Panhandle Eastern Pipe Line Company for the year ended 1940. I know that Exhibit No. 49 will show that, but if you—

A. December 31, 1940?

Q. Yes.

A. Table for Chart No. 9, Exhibit 65, shows the net operating income figure for the year 1940, in the amount of $5,714,218.

Mr. Littman: Will you please read the last answer?

(The last answer, as above recorded, was read by the reporter.)

By Mr. Littman:

Q. Now, it is a fact, is it not, Mr. Coffman, that the Panhandle Eastern Pipe Line Company earned, in the year 1940, $649,397 more than the amount of $5,064,821 shown in your Chart No. 37 of Exhibit 65 which you call "A Fair Return to Investors," is that correct?

A. It is higher by $649,397.

Q. Now, by what amount does the net operating revenue of Panhandle Eastern Pipe Line Company for the year 1940 exceed the amount of $4,993,511 shown in your Chart No. 36, as "A Fair Return to Investors"?

[fol. 6831] A. It exceeds it by $720,707.

Q. Now, Mr. Coffman, will you please state what amount of operating revenue would be required to produce this amount of $720,707 which you just named in the year 1940?

The Witness: Would you read that question, please?

(The pending question, as above recorded, was read by the reporter.)

By Mr. Littman:

Q. I have in mind, Mr. Coffman, that, due to the taxes, gross revenue considerably in excess of $720,707 would be required to produce that much of net operating income.

A. I don't believe I can answer that question, Mr. Littman.

Q. Am I correct in understanding that it would require a sum very greatly in excess of $720,707 by way of gross revenue to produce that much net operating revenue? Isn't that correct?

A. Well, I am frankly a little confused on that question for the reason that I should suppose that the only figure you could use would be the figure for the full year 1940, in which this amount that we are discussing is already included, and the total gross revenue on that amounted to $13,536,453. That already includes this item you are talking about, so when you ask how much more will it take, [fol. 6832] I don't know what you mean.

Q. Well, now, let me get at it this way: if this Commission, for example, were to want to cut rates so as to reflect a cut in Panhandle Eastern's net operating revenue for the year 1940 in the amount of $720,000, by how much would the Commission have to cut the gross revenue in order to effectuate a cut in net operating revenue of $720,000? Have I made myself clear?

A. Yes, I think I understand your question. Well, if you will assume that all of the operating expenses and other deductions, except, of course, the tax item which varies with the amount of earnings, were to remain the same, then you would merely take off the $720,707 directly from gross.

Q. Well, of course, you are begging my question, I believe, because these operating revenue deductions that you state you want to assume will remain the same and include all the taxes. Isn't that correct?

A. They include an allowance for taxes, yes.

Q. Now, assuming that all the revenue, the operating revenue deductions remained the same except the taxes, and assuming that you are going to calculate in such manner as to reflect the reduction in taxes occasioned by reason of a cut in rates, which will bring about a reduction of $720 in net operating revenue, can you state, approximately, what cut would be made in gross revenues to pro- [fol. 6833] duce this result?

A. I couldn't state that without making a [cauculation,] because as you know it is intricate. I mean you have several variables, and all problems which have several variables, one depending on the others, are difficult to calculate.

Q. In other words, you could make the calculation, but it is a rather intricate and involved task, is it not?

A. That is right.

Q. But you do know that the amount of reduction in gross revenue, that is in rates themselves, would be considerably in excess of the $720,000 of net operating revenue. You know that, don't you, in view of the 1940 tax situation?

A. I will say this: it would make a difference, whether it is substantial or not, I wouldn't want to say until I have the figure and then I can make a direct comparison.

Q. Don't you know, offhand, Mr. Coffman, even without making the calculation, that the cut in gross revenue would be at least double the $720,000?

A. No, I wouldn't say that, not by a long way, no, indeed, no. Mathematically, I don't think that will work out.

Q. At any rate, one familiar with the tax laws of 1940, could readily make the calculation, if he had sufficient time within which to do it, could he not?

[fol. 6834] A. Yes, he could make a very reasonable approximation.

Q. Yes. Will you please refer to your Chart No. 28 of Exhibit 65?

Mr. Wheat: Which one?

Mr. Littman: 28.

By Mr. Littman:

Q. Now, this chart is headed "Over-all Cost of Capital to Panhandle Eastern Based on Ideal Capital Structure." Now, this so-called ideal capital structure consists of 40 percent bonds and 60 percent common stock. Is that correct?

A. That is correct.

Q. Will you define the term "ideal" as you have used it in this Chart?

A. Well, I mean by that that from a study of various pipe line companies, as illustrated in a preceding chart in this exhibit; the number of which I will have in a minute, Chart No. 25, I found that preferred stock in a natural gas pipe line company was uncommon, of the various natural gas pipe line companies shown there in, El Paso Natural Gas is the only one, excluding the Panhandle Eastern, that has any preferred stock outstanding and that in a much smaller percentage than Panhandle Eastern. I therefore thought that it would be wise for me to make a calculation on a basis wherein no preferred stock would be outstanding [fol. 6835] ing. Then next considering in the nature of a risk which is involved in a natural gas pipe line company, the question arose as to what percent such company might well carry in senior securities and what percent would be carried by equity. It seemed to me that it probably would be in the relationship of 40 percent bonds and 60 percent common stock and merely title that "The Ideal

Relationship'' as being about the happy balance for those kinds of securities.

Q. Now, when you use the term "ideal" I presume you mean that this capital structure shown on Chart No. 28 would be ideal from the point of view of the investors.

A. And from the standpoint of the company, yes.

Q. How about from the point of view of the rate payer? Is it also ideal for him?

A. I think it is ideal for him so long as conditions remain what they are and it is impossible to get any better rates in the investors market than you can secure by this combination. After all, the customer may wish certain things, but if to get the services you have to sell securities to the investing public, you have to take them into consideration, also, so what is good for the two is good for each.

Q. Now, the cost of capital shown on Chart No. 28, Exhibit 65, is 3 percent for the bonds and 12 percent for the common stock, making a total over-all cost of 8.40 percent. Is that correct?

[fol. 6836] A. Yes, that is correct.

Q. And that is on your so-called ideal basis?

A. Yes, sir.

Q. Will you please turn to Chart No. 27, which shows a capital structure which assumes the refinancing of preferred stock by means of 50 percent bonds and 50 percent common stock, and will you please state what over-all cost of capital to Panhandle Eastern is indicated by this chart?

A. Before I answer that, may I be sure that this question states what the exhibit shows? In regard to that refinancing, it is not 50 percent in bonds and 50 percent in preferred stock; the situation is one where the preferred stock that is retired will be taken care of 50 percent in bonds and 50 pefcent in common stock, so that it wouldn't necessarily mean that the outstanding bonds and common stock were 50 percent each. I just want to be sure that we are talking about the same thing.

Q. Yes, I am referring to Chart No. 27, which assumes the refinancing as there shown and stated.

A. Yes. Well, then, the amount of earnings required would be $5,006,338.

Q. And what is the percentage over-all cost of capital to Panhandle Eastern on that basis?

A. I believe the percentage is shown in your table for [fol. 6837] this Chart No. 27.

A. The over-all rate is 7.85 percent.

Q. Yes.

Now, will you please turn to Chart No. 26, which shows the present capital structure of Panhandle Eastern Pipe Line Company, and will you please state what over-all cost of capital to Panhandle Eastern Pipe Line Company, under the present capital structure, is indicated by this chart in percents?

A. The amount is $5,077,648.

Q. What is the percent? I think your table for this chart shows the percent.

A. The over-all percent, as shown in table for chart No. 26, Exhibit 65, is 7.99 percent.

Q. Well, now, Mr. Coffman, we have this figure of 7.99 percent as the over-all cost of capital under the present capital structure, as shown by Chart No. 26, and we have 7.85 percent as the over-all capital under the refinancing assumptions set forth in Chart No. 27, and we have the 8.40 percent set forth by you in Chart No. 28 as the "Ideal Capital Structure." Now, will you state what is so ideal about this capital structure that appears to be the highest of the three in cost of capital to Panhandle Eastern Pipe Line Company?

The Witness: Would you read that question, please?

[fol. 6838] (The pending question, as above recorded, was read by the reporter.)

The Witness: If I get your question correctly, the figures don't work that way. The over-all percent, based upon the capital structure, as of June 30, 1941, was 7.99 percent or $5,077,648 and the figure on the assumption of a refinancing of the preferred stock was 7.85 percent, or $5,006,338.

Well, now, the percent as well as the dollars that you secure in the tabulations are lower for the assumption that there will be a refinancing of the preferred stock than is the case if you take the present capital structure. If I understood your question, they worked just in the reverse of what you were asking.

Q. Yes, but you haven't mentioned in your answer anything about this so-called ideal capital structure on page 28 which is the highest of the three in cost of capital. What do you say about that one?

A. Well, so far as the percent there shown is concerned, it is true it is 8.40, that is combining the 3 percent on a 40 percent debt basis and the 12 percent return on a 60 percent common stock basis, and that is just the way the mathematics worked out, that is just arithmetic, the fact that it comes out 8.40, it is just 8.40.

Q. What is "ideal" about a capital structure that [fol. 6839] costs more to Panhandle Eastern than the other two which are not "ideal"?

A. Well, I don't want to discuss the merits of the word "ideal" and if that is bothersome, it can be left out of the discussion. What I am saying is that in an analysis of various pipe line companies I discovered that there was only one besides Panhandle Eastern that had any preferred stock outstanding. Now, I take it that the reason for that must have been that a preferred stock in a natural gas pipe line company over the years has not been particularly attractive to the investors or more companies would probably have sold preferred stock. So if you then come down to the option of having bonds and common stock, the question is: about what proportion this type of business risk would stand. So far as I could see, in my best judgment, anything larger than a 40 percent amount in bonds just wouldn't be easily carried. You might have a lower amount but in any event a 40-60 arrangement was about as far as you could go in bonded debt and attract investors to the security.

Q. After you eliminate the preferred stock from Panhandle Eastern's present capital structure by this "ideal" method you then get a higher cost than is presently incurred by Panhandle Eastern, do you not?

A. You get 8.40 percent in contrast with the 7.99 percent or the 7.85 percent.

[fol. 6840] Q. Now, will you explain how you conclude that this ideal capital structure is advantageous to Panhandle Eastern and the public and the investors and the consumers?

A. Well, in this particular case, as the actual figure works out, I don't think it is as advantageous as the 7.99 or the 7.85.

Q. You mean your ideal capital structure is not as advantageous as the two you mentioned?

A. Well, I think, I believe the Securities and Exchange Commission has also talked about 40-60 in times past. This idea doesn't altogether originate from my own analysis, but has been made by statements by other commissions.

Q. We are going to discuss the policies of the Securities and Exchange Commission in these regards a little later, but from a standpoint of cost to Panhandle Eastern Pipe Lines Company, it appears, does it not, that your ideal capital structure is the most expensive of the three?

A. That is correct.

Q. Mr. Coffman, you have no doubt, have you, that the cost of capital to Panhandle Eastern Pipe Line Company after the presently contemplated financing is completed, under which Panhandle Eastern acquires Michigan Gas Transmission Corporation, will be substantially less than the 8.40 percent shown in your Chart No. 28 or the 7.85 [fol. 6841] percent reflected by your Chart No. 27 or the 7.99 percent reflected by your Chart No. 26?

A. Well, I am unable to answer that, Mr. Littman, because there is an entirely new group of figures to be carried and I wouldn't know, really, what the percentage was likely to be until I put the figures together and worked them out.

Q. You have not made any study in that connection?

A. No, sir.

Q. How much more in dollars would your so-called ideal capital structure cost Panhandle Eastern Pipe Line Company annually than under the plan shown in Chart No. 27, which assumes the refinancing of preferred stock?

A. That would be approximately $350,832.

Q. Now, the ultimate effect on the rates paid by the rate payer, that is, the ultimate cost to the rate payer of this additional $350,767, would be three or four times that much, would it not, before taxes?

A. Well, there, again, I can't make that statement, Mr. Littman, I don't know.

Q. Well, assuming the correctness of my three times figure for taxes, this ideal capital structure would cost a rate payer a million dollars more per year, would it not, than if the structure were used which is shown by you on Chart No. 27?

[fol. 6842] A. I don't know what amount of dollars it would make, nor I couldn't tell until I had actually made some calculations to ascertain the fact.

Q. Well, if gross revenues were reduced one million dollars in 1941, how much of a reduction would this company suffer in net operating income?

A. I can't answer that, because you still have a tax question in there. I don't know what it would be.

Q. Well, now, let's see for a moment whether we can't get some approximation of what the amount would be. In 1941 you have Federal excess profits taxes of 60 percent in one bracket, have you not, in the highest bracket?

A. Which exhibit are you looking at?

Q. Well, I just started to look at your Exhibit 152.

A. Yes.

Q. Am I right in stating that under the 1941 Revenue Act, $600,000 out of each $1,000,000 in the high bracket would be taken for excess profits taxes?

A. When you are juggling revenue on the one hand and dealing with tax rates on the other, it isn't that simple. I wouldn't—I just can't answer that question without making some calculations. It would be a wild guess and would mean nothing in the record.

Q. Let's assume that we have one million dollars of revenue way up at the top, the cream, and it is in the [fol. 6843] high bracket, that is, the 60 percent excess profits tax bracket. A. Yes.

Q. Now, $600,000 of that goes to the Federal Government for excess profits tax, does it not, under the 1941 Revenue Act; isn't that right?

A. If it is in the 60 percent bracket, it goes, yes.

Q. Incidentally, Panhandle Eastern Pipe Line Company is in that 60 percent excess profits tax bracket, is it not?

A. Well, it may be at the present time, yes.

Q. Well, your exhibit shows that, does it not, your Exhibit 152 shows that?

A. Yes, on part of the remaining income there is a 60 percent tax.

Q. When a rate reduction of one million dollars is made, for example, it comes right off the top, does it not, and right out of the top bracket; isn't that correct?

A. Well, as you reduce the net taxable income, you will go from one bracket to the next lower. You can describe

it any way you please; you just go from a higher bracket to the next bracket beneath.

Q. Now, we have the $600,000 that would come off for excess profits taxes out of this one million dollars of revenue which falls in the highest bracket. Now, another $124,000 would come off, would it not for normal surtaxes? [fol. 6844] A. Approximately.

Q. So that a rate cut of one million dollars of revenue in that bracket would reduce the company's net operating revenue by only $276,000, would it not?

A. Well, I haven't made those calculations. I don't know what the dollars are. I don't know whether your calculation of $276,000 is correct or not.

Q. Well, I just added the $600,000 of Federal excess profits taxes to the $124,000 of normal income tax and surtaxes and deducted the $724,000 from the one million dollars to get a reduction in net income of $276,000. Now, what is wrong with my calculation?

A. Well, as I say, whenever you, in any calculations, are dealing with variables; so far as I am concerned, as an analyst, I prefer to work all the items out to be sure I am right.

Q. I am going to ask you to—will you please refer to Exhibit 152? On the first page of that Exhibit about the center of that page under the heading "Taxes Computed at Rates Levied in the Revenue Act of 1941," you have an item "Taxes at 60 Percent on Remaining $2,708,000," have you not? A. There is such a figure.

Q. Now, that indicates that Panhandle Eastern Pipe Line Company is in that very dignified 60 percent bracket, [fol. 6845] at least to the extent of $2,708,000; isn't that right?

A. For this calculation, that is the figure we use, that is right.

Q. And you add an additional 10 percent on top of that in one of your tables in Exhibit 65, don't you?

Well, let's pass that for the moment. Will you compute for me the amount of reduction in net operating revenue to Panhandle Eastern Pipe Line Company that would result if this company were to cut its rates one million dollars?

Of course, that one million dollars would fall within that 60 percent bracket. Now, if this calculation takes time, why, I—

A. I wouldn't want to make that while I am sitting here.

Q. I see. It is perfectly all right for you to make the calculation by tomorrow.

A. May I be sure that I have the assumption? I am to assume that rates to customers are to be so reduced that there will be a million dollars less gross under this calculation; is that a fair statement?

Q. Of gross revenue. A. Of gross revenue?

Q. Yes, and assume that the million dollars of gross would fall within this 60 percent tax bracket. That is a [fol. 6846] correct assumption, isn't it? That is a fact, isn't it?

A. As I say, if you are in one tax bracket and the revenue goes down so that you slide into the next bracket, you don't slide up, you slide down.

Q. Well, you aren't going to slide down below the 60 percent bracket if you are only going to take one million dollars off the top, are you?

A. I don't know whether that is true or not.

Q. Well, your Exhibit 152 shows that you have $2,708,000 in that 60 percent bracket. You would have to slip a lot further down the line than one million dollars to get below the 60 percent, wouldn't you?

A. That may be true, Mr. Littman, and after I have made the analysis, if it is true, I will be the first to state it, but I would rather make the calculations first, if you don't mind.

Q. Very well. I wanted to make certain that you knew what I had in mind rather than to have you come back with a figure that is not the one we want.

A. I understand your assumption.

Q. Also assume, Mr. Coffman, for purposes of this calculation, that all other operating revenue reductions except Federal taxes remain the same.

Mr. Wheat: Do you want this on the basis of the [fol. 6847] 1941 Act?

Mr. Littman: Yes.

By Mr. Littman:

Q. Will you please refer to Chart No. 19 of Exhibit 65? Now, in this chart you [shown] earnings price ratios of natural gas pipe line common stock for the years 1937 to 1940, inclusive, for five natural gas pipe line companies as shown in the Chart; is that correct? A. Yes, sir.

Q. Now, in order that we may have no misunderstanding as we go along, will you please define the term "Earnings—Price Ratios"?

A. Well, the basic figures for Chart No. 19 of Exhibit 65, are shown in the table for Chart No. 19 and an earnings price ratio is the relationship as here used of the average of the high and low prices for the securities of the companies therein discussed with the earnings per share. In other words, it is the average of the high and low price for a security of 1937 and the earnings per share for 1937 and the ratio shown is secured by dividing the earnings figure for the given year by the average of the high and low price for the same year, so that you arrive at the percentages which are shown at the top of the columns in that chart.

Q. Now, these earnings to which you have referred [fol. 6848] are not the earnings that were, in fact, distributed?

A. No. When I say "earnings" I am talking about the full earnings that were made. I am not talking about dividends or that portion of earnings which was distributed. It is the full amount of the net earnings that were reported that were available per share.

Q. Now, in the next chart, that is, Chart No. 20, you show the current earnings price ratio of these five pipe line companies, including Panhandle Eastern, for the calendar year ended December 31, 1940, except for Panhandle Eastern which is for the twelve months period ended June 30, 1941, related to the average market price between January 1 and August 31, 1941; is that a correct statement of what this chart purports to show?

A. Generally speaking, you are right, but as I understood your statement, not all of these earnings per share figures were shown for the year ended December 31, 1940, as I understood you to say. As you see, they are clearly marked, the Interstate Natural and Memphis Natural cover the year 12-31-40. El Paso and Southern and Panhandle are for the years ended June 30, 1941. Except for that

correction, what you have stated is what I have shown in Chart No. 20 in Exhibit 65.

Q. I am sorry, I didn't intend to mislead you on those dates. They are clearly shown.

Now, are these the only four pipe line companies that [fol. 6849] you consider to be comparable to the Panhandle Eastern Company?

A. These pipe line companies that I have here shown are the only pipe line companies that I believe to be comparable and upon which there is adequate data available to make tabulations in regard to investors' appraisal of the risks of capital.

Q. Now, what do you mean by the latter part of your answer?

A. Well, I mean that in calculations I have made and used in this study, I have attempted to ascertain what investors felt was required for them to make an investment. Well, in order to make such study, it was necessary for me to find available information on the different securities each company had outstanding in the hands of the public so there would be figures available as to the market prices and so on, otherwise, I did not have one basic figure that was necessary to calculate an earnings price ratio.

Q. Now, where did you draw the line with respect to a company whose common stock was not sufficiently distributed in the hands of the public, so as to warrant a proper analysis of earnings—price ratios?

A. No, I didn't quite say that. I say if any of the securities are in the hands of the public so that you can get a reliable market quotation on the security, I will use it, [fol. 6850] but in any cases, for example, where either an entire bond issue or all of the preferred stock or all of the common stock is owned by some holding company so that there were no quotations of the bond on the market, then I lacked one fundamental factor to make this calculation and that company was eliminated, but if I could find reliable market quotations, then I include all of the companies. In so far as I know, taking my three exhibits here, I have included all such companies.

Q. Is it your opinion that the market quotations on Panhandle Eastern's common stock are reliable for purposes of making a determination of earnings—price ratios?

A. Well, it is the only guide that you have for a share of stock transferring hands from one person to another. I don't know what else [hou] can use other than that. The United States Treasury, so far as I can see from experience I have had with them, contend that it is a very reliable guide to fair value.

Q. Well, now, first, I would like to have you specifically answer my question as to whether or not you consider the market quotations on Panhandle Eastern's common stock a reliable basis for a determination of earnings—price ratios.

A. So far as the investor is concerned, I say it is the only guide to the particular value that you have at the [fol. 6851] time. In other words, if a buyer of a security puts in a bid for the stock and ~~finally secures~~ it at a price so that there is a stock transaction, that price for that share is apparently its value, so far as those two people are concerned. That is what I used.

Q. I am not talking about the mind of the investor. I am talking about the reliability of the available market data on Panhandle Eastern's common stock for the purpose of determining current earnings—price ratio.

A. Well, earnings—price ratios involve two factors, earnings per share and the stock price, and that is all earnings price ratio means, so I don't see how I can answer it.

Q. Perhaps, I can make myself more clear by asking you what percent of Panhandle Eastern's common stock is in the hands of the public.

A. I don't remember offhand.

Q. Don't you show it in one of your exhibits? Suppose I refer you to your Exhibit No. 64, Appendix B, page 8. Doesn't that show the data?

A. Appendix B, page 8, of Exhibit 64, shows a schedule of the distribution of the stock as prepared by Mr. Knapp of the Federal Power Commission for the Hope Natural Gas hearings, and that indicates that there were $12,017,544 of bonds and notes in the hands of the public—

[fol. 6852] Q. (Interposing) And 1,589,150 shares of stock, common stock outstanding.

Q. What was that, again?

A. $1,589,150. I think I said "shares." It is dollars.

Q. Mr. Coffman, doesn't your page 8 of Appendix B of Exhibit 64 show that less than 8 percent of Panhandle Eastern's common stock is in the hands of the public?

A. Yes, it indicates that there is about 7.8 percent of the common stock in the hands of the public.

Q. The balance is owned by affiliated companies?

A. Yes, sir.

Q. And what affiliated companies are those?

A. Well, the Panhandle Eastern Pipe Line Company securities are owned [parly] by Missouri-Kansas Pipe Line Company and the Columbia Gasoline Corporation, a subsidiary of the Columbia Gas and Electric Corporation.

Q. Isn't that company the Columbia Oil and Gasoline Corporation? A. Yes, that is what I meant to say.

* * * * * * * * *

[fol. 6853] By Mr. Liftman:

Q. Can you state the proportion of ownership by those two companies of the common stock?

A. I don't believe I can state exactly, but as I recall there are some shares in the hands of the Trustee. I believe, as I recall the percentage, that something like 48 percent is owned by the Missouri-Kansas Pipe Line Company and the rest that is outstanding is held by the Columbia Oil and Gasoline Corporation and the shares that are being held by Gano Dunn, the Trustee,—I would have to look it up to get the exact percentages. I think that is generally close.

Q. So that less than 8 percent of the outstanding common stock of Panhandle Eastern Pipe Line Company is in the hands of the public and is traded on the market; is that right? A. That is correct.

Q. Now, what about the preferred stock? None of that is in the hands of the public?

A. None of that is in the hands of the public.

Q. All of that stock is beneficially owned by Columbia Oil and Gasoline Corporation; is that correct?

A. Yes, sir, that is correct.

Q. Now, referring again to this approximately 8 percent of common stock that is in the hands of the public, isn't it a fact that only a small fraction of that 8 percent [fol. 6854] is actually traded—

A. I don't believe I can answer that question, Mr. Littman.

[fol. 6855] Q. Do you have any data that will show how many shares of Panhandle Eastern Pipe Line Company were actually traded in the market within recent years or over a given period?

A. I do not recall that I have such figures in this exhibit.

Q. Maybe you do not have them in your exhibits but have you any such data in your working papers?

A. No, I do not recall having tabulated the trading. I recorded only the prices.

Q. Did you make any investigation of the amount of trading of Panhandle Eastern's common stock?

A. No, for this study I did not, because it was not necessary. All I needed was two factors, the earnings per share on the one hand and the price quotation on the other and those were the two which were used to make the calculations of the ratio.

Q. Isn't it important to ascertain those facts in order to know whether the amount of trading is sufficient upon which to make a proper analysis of the current earnings price ratio?

A. No, I do not think so. In determining the investor's appraisal of the risk of capital, you secure that by using the price quotations and if there are any shares traded so that a price is recorded in a reputable exchange, there can [fol. 6856] be no dispute about that particular price.

Q. Well, is Panhandle Eastern's common stock traded on any stock exchange?

A. It is traded between a present owner and a prospective purchaser so that there are quotations. It does not make any difference which exchange or whether it is over-the-counter so long as there is an actual transaction and a quotation.

Q. Well, the trading on the market of Panhandle Eastern's common stock is rather thin, isn't it?

A. There again, that is a relative thing. If you were comparing, for instance, the trading in Panhandle Eastern with the trading in General Motor's common stock, I would say it was relatively thin, yes, sir.

Q. If Panhandle Eastern's stock in the hands of the public represented less than 5 percent of the total out

standing common stock, you would not consider it reliable at all, would you?

A. I still say that a quotation is a quotation. I do not care whether it represents one share or whether it represents 100,000 shares. It is still a quotation.

It is a price established at an arm's-length transaction, so far as I am concerned.

Q. Would you consider the earnings price ratio of Panhandle Eastern reliable even if less than 5 percent of [fol. 6857] its shares were outstanding in the hands of the public and traded?

A. I say that a price quotation is a quotation and it is the only guide you have, regardless of the number of shares traded or as to what the investors who were involved in that particular transaction think about the price and it is the only price available which I could use to calculate an earnings price ratio and I have done no different here than Mr. Knapp did in his own exhibit.

I merely followed his own procedure.

Mr. Wheat: To whom are you referring when you mention Mr. Knapp?

The Witness: Mr. Knapp was formerly with the Federal Power Commission and introduced some testimony in the Hope Natural Gas Company case on behalf of the Federal Power Commission.

As a matter of fact, the list and exhibit referred to, Exhibit B, was taken directly from his own exhibit.

By Mr. Littman:

Q. Well, are you relying upon Mr. Knapp's testimony for the purpose of determining the amount of dollar return required by Panhandle Eastern Pipe Line Company?

A. No, not directly, but the exhibit which is Exhibit B to which you referred a short time ago as to the outstanding securities and how they were held, was all taken [fol. 6858] from his exhibit.

Q. I am not now questioning you concerning the accuracy of the statistics shown in Appendix B, Page 8, but I am asking what reliance can be placed upon an earnings

price ratio which reflects the trading on the market of a fraction of 8 percent of common stock of a company that is in the hands of the public.

That is the matter that I wanted to discuss with you.

A. Yes, and my answer is just exactly what I have given you, namely, that there are transactions in this stock upon which there are prices and I used those prices irrespective of whether one share or 100,000 shares were traded.

If there was a reliable price quotation, I used it. Otherwise, I could not have made the calculation.

Q. And you considered the price quotation reliable for Panhandle Eastern Pipe Line Company, notwithstanding the fact that only 8 percent of its common stock is in the hands of the public and only a fraction thereof is traded?

A. Yes, it was the only guide there was on the subject available.

Q. I know it was the only guide. There isn't any question about that. That was the only data available but I am asking you what you think about those data for the purposes to which you put those data?

[fol. 6859] A. I still say if a stock changes hands at $21.75 a share, whether it be one share or more, that is the price for that transaction and that transaction is reliable.

Q. Reliable for the purposes of working out an earnings price ratio for purposes of this proceeding?

A. I think so.

Q. Isn't it a fact, Mr. Coffman, that you actually made numerous eliminations of companies whose common stocks were outstanding in the hands of the public to an extent less than 5 percent in working out the earnings price ratios in your Exhibit 63?

Did you or did you not? You can answer that yes or no.

A. No, I am sorry, I cannot answer it that way, Mr. Littman. I did not take any arbitrary percentage. What I had in mind was to ascertain whether the great bulk of invested capital represented by different securities did have quotations which I could secure.

Now, if there was any block of the capital which was entirely held by some affiliated or holding company so that I could get no quotation, I eliminated it.

It may figure out to be 5 percent, I do not know. The original elimination was based upon whether I could get the securities or not, I mean the quotations.

Q. Didn't you draw the line at 5 percent for purposes of Exhibit 63?

[fol. 6860] A. It may work out that way but I did not start out with the idea of 5 percent, as such. It was only after I had made considerable tabulations to see what I could find as being available for calculations.

Q. Let me refer you to Page 11 of Exhibit 63, Mr. Coffman.

Now, on that page, you discuss your analysis of data on electric utility operating companies and you state that eliminations were made from the complete list of 40 telephone, electric and gas companies for various reasons and then you state that you eliminated "companies whose common stocks were outstanding in the hands of the public to an extent less than 5 percent."

Isn't that correct?

A. Yes, and that is correct only as applied to Section 3, Page 11 of this Exhibit 63 which applies to electric utility operating companies.

Q. Why did you eliminate from this list of electric utility operating companies those companies whose common stocks were outstanding in the hands of the public to an extent less than 5 percent?

A. Because of that particular classification, by eliminating those items, all the other important companies were still left in the tabulation so the ones that happened to be eliminated were immaterial, so far as the results were [fol. 6861] concerned.

There was no purpose in going on with that additional work.

Q. How do you know whether or not they were immaterial? Did you make a calculation to see what the results would be?

A. No, but having a familiarity with the companies, I felt pretty sure, after an examination of the ones that were left, I felt I had a pretty good representation of that particular class of utility company.

Q. Then you consider the data with respect to all of the companies that you eliminated because of the fact that there were outstanding in the hands of the public common stock to an extent less than 5 percent—then you eliminated these companies notwithstanding the fact that their earnings price ratios were just as reliable as the other companies which have more than 5 percent of their common stock in the hands of the public?

A. No, that is not quite correct. I think we are talking about two different things.

In this exhibit to which you have referred, it is specifically stated that we are talking about electric operating utility companies and nothing else and that situation applied to that list.

All the companies were studied and those with 5 percent [fol. 6862] or less than 5 percent were eliminated and I felt that the resulting items and companies which were left were absolutely representative of that particular class of public utility company.

Q. And those that were eliminated for that reason were just as reliable?

A. You could have put the figure in but it would not have changed the result a fraction.

Q. You do not know that, do you, without having first made the calculation?

A. I do not know that for certain but knowing the natures of the companies and so on against those actually included in the list, I think I have a pretty reasonable generalization.

Q. Now, you show in Charts Nos. 19 and 20, the earnings price ratios of common stocks of the Interstate Natural Gas Company, do you not? A. Yes, I do.

Q. That is a rather small company, is it not?

A. Well, in comparison to some of the others, yes.

Q. What is the amount of securities outstanding of that company as shown in your Exhibit 64?

On Page 3, Appendix B, of Exhibit 64, there is outstanding common stock of the Interstate Natural Gas Company as of December 31, 1940, $6,529,530 of which $1,893,564 is in the hands of the public and the remainder is in [fol. 6863] the hands of affiliates.

Q. Now, Panhandle Eastern, as of the same date, had $54,451,000 of securities outstanding in the hands of the public, is that correct?

A. That is including all forms, bonds, notes, preferred and common, $54,451,719.

Q. We are now comparing the sizes of [thse] companies as represented by their total outstanding securities? A. Yes.

Q. Now, when you compare Interstate Natural Gas Company, you are comparing a $6,500,000 company, as far as outstanding securities are concerned, with a company having $54,500,000, approximately, is that right?

A. Yes, that is correct, but I would like to amplify my answer by stating that so far as the investor is concerned, size is not a predominant factor in his mind. He is interested in the potential earning capacity of the company and if a small company has greater potentiality in that respect than [an] larger company, other things being equal, he would prefer the small company as against the larger so that so far as the investor's appraisal of the risk of capital is concerned, it makes no difference to the investors.

Q. Of course, I may have another purpose in mind in asking you these questions as will later be revealed.

[fol. 6864] A. All right.

Q. Now, Memphis Natural Gas Company also appears in Chart No. 20 and that is another small company, is it not, which has only $4,993,000-odd of securities outstanding, is that right?

A. Yes. On Page 4 of Appendix B of Exhibit 64, it is shown that the Memphis Natural Gas Company has total securities outstanding in the amount of $4,993,400 of which $2,381,678 are in the hands of the public.

Q. You also show in Chart No. 20 the current earnings price ratios for Southern Natural Gas Company. That company has been in financial difficulties, has it not?

A. It was a few years ago, yes.

Q. Is it still in financial difficulties?

A. I do not believe so.

Q. You are not sure about that?

A. I do not think it is in financial difficulties, as I understand your term. Today it is beginning to show earnings and it is picking up in its business.

I would not say it was in financial difficulties.

Q. It was recently a bankrupt company, was it not?

A. Well, it depends on what you mean by "recent". As I recall—

Q. (Interposing) Suppose you give me the date.

A. As I recall it—I am not certain of the date—but as [fol. 6865] I recall, it was sometime in 1936. I would want to check that, but in terms of recent, it was not last year or the year before, as I remember it.

Q. Are the investors in that company seeking to make up today the losses which they experienced in the past, as you indicated was the thing that was in the mind of the investor?

A. Well, I think you are talking about something different there. I do not remember now the refinancing plan that was laid out but whatever the plan was in the reorganization it presumably took account at that time of those items and the losses were stricken at the time of the plan.

Q. In other words, the investors wrote them off when the company went through the wringer, so to speak?

A. That is right—he did not write them off. He was forced to write them off.

Q. Now, that company has around $30,500,000 of securities outstanding in the hands of the public, does it not?

A. Yes, it has total securities outstanding of $30,473,304.

Q. Now, will you please turn to Chart No. 22 of Exhibit 65.

In this chart you show, by the green bar at the extreme left side, that the average of the pipe line companies was [fol. 6866] 12.99 percent with respect to earnings price ratio based on 1941 market prices. Is that correct?

A. Yes, sir.

Q. Now, what companies have you averaged to secure this figure of 12.99 percent—by the way, this 12.99 percent relates only to common stock, does it not?

A. That represents the various companies that are shown in, or is based upon the various companies shown in the preceding exhibit.

That is the chart that we just referred to as to the pipe line companies considered.

Q. Including Panhandle Eastern?

A. No, not including that because that is the basis for comparison.

Mr. Wheat: Do you want to check on that?

The Witness: I will check on Panhandle Eastern.

Mr. Littman: I was under the impression that Panhandle Eastern was included.

The Witness: I say I will check that and see. My recollection was the other way around. I will have to make some calculations, I think, to check that but I can report back to you, Mr. Littman.

Mr. Wheat: Just a second, I think we can give you that figure.

Mr. Littman: I check it to be the average of the five [fol. 6867] companies, including Panhandle Eastern Pipe Line Company.

That is, it includes the following companies: El Paso Natural Gas Company, Interstate Natural Gas Company, Memphis Natural Gas Company, Southern Natural Gas Company and Panhandle Eastern Pipe Line Company.

The Witness: Yes, that is correct.

By Mr. Littman:

Q. Now, this 12.99 percent shown on Chart No. 22 as the average earnings price ratio of those five pipe-line companies based on 1941 market prices is a straight mathematical average, is it not? A. Yes, it is.

Q. Do you think that is a proper kind of average to use when you have companies having the varying amounts of securities outstanding as you have heretofore testified?

A. ~~I think~~ it is reasonably accurate because there are some difficulties involved in working it out any other way where you have variations as to the class of security you have outstanding.

That is, some companies having only common stock, others having common, preferred and bonds and others having just common and bonds.

Q. We are just talking about common stocks of these companies, are we not?

A. That is correct and, therefore, the earnings price [fol. 6868] ratio that you get on these is representative of their particular division for each company.

Q. You think it is proper to simply add the five ratios and divide by five to get the proper figure?

A. I do because you make a computation and the only way you can make such a computation as this is on the basis of the earnings per share and when you get earnings per share, then you talk in terms of price per share and that gives you the percentage relationship.

Q. Now, when you do that, you are giving just as much weight to Memphis Natural Gas Company, having a 15.10 earnings price ratio and having only $4,993,400 securities as you give to Panhandle Eastern Pipe Line Company, which has $54,451,000 of securities outstanding?

A. That is correct and the reason for that is the one I have already given, that the investor, after all, looking over the entire field of investments that is available to him, compares the earnings per share against the price and it makes no difference whether it is large or small.

Q. Mr. Coffman, do you believe that the straight mathematical average of all these companies, giving each one equal weight, is the proper way of getting the average of the earnings price ratios of those companies?

A. Yes, the [earnins] price ratios for the common stock, [fol. 6869] yes, sir.

Q. Now, will you look at your Exhibit No. 63 and tell me whether you used the mathematical average in determining your average earnings price ratios or whether you used the weighted average?

A. Before we go on, Mr. Littman, we might as well understand we are talking about two different things. This present exhibit to which you are referring is covering over-all capital which includes bonds, preferred stocks, and common stocks.

When you do that, it is possible to make and use a weighted average and I used it; but when you talk in terms of common stock, you have some difficulties because there you are trying first to ascertain the percent of earnings that are available for the common shares only, where there is senior capital outstanding, and it is a little difficult to do so when—

Q. (Interposing) What is difficult about it?

A. The amount of earnings that are finally available are dependent upon how many senior charges are ahead of it and if the company has nothing but common stock outstanding, all of the earnings go to common; but another company, if you have interest charges and preferred dividends and something on common, other types of securities that are paid first, you have to make allowances for those items.

[fol. 6870] In other words, you have to break your earnings figure down per bond, per preferred stock, per common. That is the reason you come out with a per-share earning.

Q. You could weight them, according to outstanding stock, couldn't you?

A. Well, I still say that where you have some companies that have all common and others that have other types of capital outstanding, it works out as accurately to talk in terms of per share.

Q. You show on Chart 22, by a yellow bar, the "Actual public financing based on price to seller" for the Northern Natural Gas Company at a cost of 11.35 percent, is that correct? A. Yes, sir.

Q. Now, that 11.35 percent is not comparable to the 11.53 percent shown immediately to the left for Panhandle Eastern Pipe Line Company and the 12.99 percent shown by the green bar as average of pipe-line companies, is it?

A. That shows the net amount and, in my opinion, is the most and best pragmatic test of what you have got as to what the market actually said about a common stock and natural-gas pipe-line common stock in September, 1941—

Q. (Interposing) That is not my question—

A. I am answering your question.

Q. That is not my question at all, sir. In order to save [fol. 6871] time, I hope you won't mind my breaking in.

What I am getting at is the two bars at the extreme left represent the yield price to the public, do they not?

A. They represent the yield price to the investor that holds the stock right now.

Q. And the yellow bar represents the price to the Northern Natural Gas Company, that is, to the seller, does it not?

A. That is correct, based on the price to the seller.

Q. Now, in that regard, these three bars are not altogether strictly comparable, are they, because two are the yield price to the investors and the one, namely, the Northern Natural, is the yield price to the seller?

A. They are not entirely comparable on that basis.

Q. That is what I mean.

A. But the point is, the purpose of the exhibit was not to contend that. The purpose of the exhibit was to show exactly what the investors said in regard to investments of this kind regardless of which way you take it.

Q. I understand that but I wanted to make the record clear on that before proceeding with a more full discussion of these other matters.

Now, the percent for Northern Natural Gas Company comparable to the 11.53 shown in this Chart No. 22 for Panhandle Eastern Pipe Line Company and to the 12.99 percent shown as "Average of pipe-line companies" is [fol. 6872] shown on Chart No. 21, is it not?

A. That is correct.

Q. And what is the comparable figure?

A. Before adjusted to reflect the effect of the tax, as clearly indicated there, it is 11.72 percent; 10.38 percent after the tax.

You are taking the after-the-tax figure. The 10.38 percent is the comparable figure with the 11.35 percent.

Mr. Littman: Will you please read back that last answer?

(Whereupon, the last answer was read by the reporter.)

By Mr. Littman:

Q. Well, the 10.38 percent figure for Northern Natural Gas Company would be comparable to the 11.53 percent figure and 12.99 percent figure shown in Chart 22?

A. That is correct.

Q. Now, your average pipe line companies in Chart No. 22 showing the figure to be 12.99 percent, does not include the Northern Natural Gas Company, does it?

A. No, it does not.

Q. Why not?

A. Because at that particular time, this financing was not done and these shares were not in the hands of the public.

Northern Natural common stock was not held by the pub-
[fol. 6873] lic until this issue on September 10 and the study I made was completed before that.

There was not anything available.

Q. Well, you have been using Northern Natural Gas Company data which was available for purposes of this exhibit.

A. Yes, and that is easily explainable. To have gone back and recalculated everything I had done would have cost a lot of money and there was no purpose in it when, after the study was completed, a few additions showing that alone would very definitely show what was happening.

In other words, after I completed the study, I could not go back and re-do the whole thing unless somebody was willing to pay the cost for that work and wait a considerable period of time for it and I was not willing to do it for my health.

Q. The only purpose that it would have shown would be to reduce the average of pipe line companies substantially below 12.99 percent.

It certainly would have done that, would it not?

A. Well, there would then be six companies instead of five and 10.38 divided by that, it would be less than one-half of one percent difference. I have not made the calculation but it would not have made any more difference than that, which I do not call substantial.

[fol. 6874] Q. One-half of one percent in earnings price ratios is a rather substantial amount of dollars, is it not?

A. Well, yes, it will be a fair amount in dollars, but, after all, the word "substantial" can mean different things. I just want to be clear that if it were one percent or one and one-half, that would be more substantial.

Q. And because of the tax situation, it becomes substantially greater when speaking in terms of gross revenue,

isn't that correct? That is the same question we discussed earlier this afternoon.

A. I am sorry, I do not quite see the application of the earnings ratio, here, to the gross revenue, for the moment. What is your point?

Q. You do not understand my question?

A. I do not quite see the connection that you are now raising to the earnings. I fail to follow you, in other words, from the earnings price ratio, for the moment, to the increased earnings.

Q. Well, earnings price ratio, if applied to the invested capital, will produce a given amount of dollars, will it not?

A. That is correct, but I did not do that in this case, as you will recall.

Q. I am just leading up to an explanation of my question.

[fol. 6875] Now, when you get those dollars, those dollars represent the net operating revenue to the company, do they not, or return to the company or profit or whatever you choose to call it?

A. Well, if you mean that additional amounts of money in the firm will give you a higher earnings so that you will have a higher earnings price ratio, then the dollars are already there but I get the ratio I am talking about, that is the result, not the cause and, consequently, I do not follow your line of reasoning for the moment.

I did not multiply anything to get a gross revenue figure by earnings price ratio so I am unable to follow your line of questioning.

Q. If you cannot follow it, I do not think we had better pursue it. I think the record is quite clear.

You used 12 percent as the cost of common stock to Panhandle Eastern, didn't you?

A. That is correct.

Q. You based that upon the price earnings ratio?

A. I based that upon what the investor says he will require to finance the company.

Q. On earnings price ratios? A. Yes, that is correct.

Q. Now, state whether or not your 12 percent figure [fol. 6876] is predicated in any way upon the average of

the pipeline companies' figure of 12.99 percent which is shown in Chart No. 22, Exhibit 65?

A. The 12 percent is a judgment figure based upon this preceding study which shows these various items.

Q. All right.

Now, I would like to have you state how you arrived at this 12 percent, give us the process that you went through to get at this 12 percent cost of common stock to Panhandle Eastern?

A. I based it upon the considerations which are in support of Chart No. 22 in Exhibit 65 wherein, after a study, I observed that the earnings price ratios of the pipe line companies which have been enumerated, the average was 12.99 percent, practically 13 percent.

Q. That is a different kind of a figure, isn't it, than the 12 percent that you finally adopted? That 12.99 percent represents the cost to the public?

A. And that is what the 12 percent represents. I am saying that the 12 percent to finance in common stock, Panhandle Eastern requires that type of earnings price ratio. You have to have those earnings to support it.

Q. In other words, the 12 percent figure shown on the extreme right part of Chart No. 22 represents the cost to the public?

[fol. 6877] A. To the investing public, that is correct.

Q. Aren't you confused, Mr. Coffman? That column is headed, "Estimated for new financing", Panhandle Eastern Pipe Line Company. A. Yes.

Q. Isn't that the cost to Panhandle Eastern Pipe Line Company, 12 percent on the common stock?

A. I am saying and using 12 percent on the common stock right through.

That is, the 12 percent is used as a part of the $5,064,821 we have been talking about.

Q. The 12 percent could not be both the price to the investors and the price to the Panhandle Eastern Pipe Line Company, could it?

A. I am saying that so far as the company is concerned, if it were to finance again, the investors will require that ratio in order to be interested sufficiently to put up the money needed if common stock is the medium

of capital to be used, that is, the type of securities to be used.

Q. The investors would require what ratio?

A. The 12 percent.

In other words, if the Panhandle Eastern is to go to the public, they are going to have to see an earnings price ratio of 12 percent if, under the conditions at the date of this [fol. 6878] study, the public would or could be interested in supplying the money on a common stock basis.

Q. If the earnings on the equity capital was 12 percent, as you appear to recommend, what would you expect the dividends to be, in percent?

A. I do not know what the dividends would be because, after all, there are a number of items that have to be considered as a matter of managerial policy as to what will be done in regard to distributing earnings.

The mere fact that any company earns so much money on its common is no guarantee whatsoever that you will get any or a large part of it.

Q. Mr. Coffman, you were explainnig how you arrived at this 12 percent and what it represented.

Now, I interrupted you for purposes of clarification. Will you continue with your explanation?

* * * * * * * *

A. The right-hand column captioned "Panhandle Eastern Pipe Line Company", relating to common stock at 12 percent, is a judgment figure based upon the earnings price ratios of various pipe line companies upon the actual earnings price ratio of Panhandle Eastern Pipe Line Company [fol. 6879] and upon the best test, it seems to me, because it is more recent, of the Northern Natural Gas Company to arrive at a figure and the 12 percent is not an average or an arithmetical figure but it is a judgment figure wherein I felt that I had discovered very clearly that investors in the market were telling the various natural gas pipe line companies that they, as investors, were not interested in buying common stocks in natural gas pipe line companies unless they could see a ratio of about 12 percent.

I had 12.99 percent on the average; 11.53 percent on Panhandle, as such, 11.35 percent for Northern and I selected 12 as being within reason.

* * * * * * * * *

Q. Tell me how you got up to 12 percent for Panhandle Eastern Pipe Line Company from the 11.35 percent shown on Chart No. 22 for the Northern Natural Gas Company?

* * * * * * * * *

A. Northern Natural Gas Company, excuse me, had, before the financing at the date of June 30, 1941, when [fol. 6880] Appendix B on Page 6 was prepared for my Exhibit 64, only two types of securities outstanding, bonds and common stock.

In the case of Panhandle Eastern, there were bonds, preferred stock and common stock so that I felt some allowance had to be made for the fact that there were two classes of senior capital preceding the common as against Northern Natural and all investors purchasing securities usually give weight to those considerations because the more senior charges you have prior to the stock you hold, obviously, the more hazard you have as to what out of the total earnings, you may be able to participate in and, therefore, exercising my judgment, based upon that knowledge, I selected 12 percent, giving some weight to the average of 12.99 and also giving some weight to Northern Natural but taking into consideration that the capital structures were different as between the companies and 12 percent was, in my judgment, the reasonable figure.

Q. Now, is this 12 percent figure which is shown on Chart No. 22 for Panhandle Eastern Pipe Line Company strictly comparable to the 12.99 percent figure shown in that chart as "average of pipe line companies"?

A. Yes, I think it is on the same basis.

Q. That is, that is the return required by the public?

A. Yes, if they see that, I think they would be willing [fol. 6881] to invest in this kind of common stock.

Q. And is the 12 percent shown on Chart No. 22 for Panhandle Eastern Pipe Line Company comparable to the 11.53 percent shown on Chart No. 22 for Panhandle Eastern Pipe Line Company? A. As to type, yes.

Q. They both represent the amounts required by the public? A. That is correct.

Q. Why do you expect investors to require 12 percent for the new financing of Panhandle Eastern Pipe Line Company when your own data show that the present earnings price ratio on Panhandle Eastern Pipe Line Companys stock is 11.53?

A. Well, because on the present basis with the bonds, preferred stocks and common outstanding, you have one relationship.

If there is to be new financing and weight is given to the possibility of eliminating the preferred stock, it then changes the relationship of both the bonds and the common stock and some allowance had to be made for that and our experience and my experience in this business of advising investors over a period of time indicated that some allowance would have to be made.

I know investors well enough to know that they make [fol. 6882] calculations of that type or make considerations of that type.

Q. Isn't this 12 percent figure shown in Chart No. 22 occasioned by reason of the use of your ideal capital structure which we have heretofore discussed?

A. No, it had nothing to do with that, as a matter of fact.

What you get in the ideal capital structure is merely a statement which the Commissions have used from time to time that a 40-percent bond classification and a 60-percent common stock classification would seem to be a rather appropriate capital structure and I merely applied the percent already found in this exhibit that you are talking about, namely, 12 percent and I applied it so 60 percent of 12 and 40 percent of 3 gives you 8.4.

Q. Now, you used the 12 percent in order to finance 60 percent of the capital structure by common stock as shown by your Chart No. 28, isn't that correct?

A. I applied the 12 percent, that is correct.

Q. Now, then, that is why you applied the 12 percent, is it not?

A. No. You get right to the question of what balance shall you have between bonds and preferred stock. Well,

the Securities and Exchange Commission has used, on several occasions, 40 and 60, saying if more equity capital [fol. 6883] is going to be put in the business, 40 and 60 would seem to be reasonable and 40 and 60 give you the two figures you have there.

The rates having been determined by a different process, that is, studying the actual markets, you find 12 percent for the common and, allowing for the increase in bonds that would take place there, it comes to 3 percent cost on the bonds and applying 3 percent by 40 and 60 percent by 12, you get 8.40.

In other words, the result of that study comes by a determination already made. This determination is not predicated upon what you are reading at all.

Q. Now, Mr. Coffman, the present holders of the common stock of Panhandle Eastern Pipe Line Company are only requiring 11.53 percent earnings on that common stock, according to your Chart No. 22, isn't that correct?
A. That is correct.
Q. Now, if that means anything, why do you expect the investor to require something more than that, namely, 12 percent?
A. Because, as I have tried to indicate, you have a certain relationship of common stock, preferred stock and bonds today.

If, in the future, further common stock is used for financing, that relationship will thereby change and I exer- [fol. 6884] cised my judgment as to what effect that change in capital structure by way of number of shares outstanding would be having on the common stock earnings price ratio required by investors.

Q. But, Mr. Coffman, if you will turn to your Chart No. 26, you will see that you are applying the 12 percent to the present amount of outstanding common stock.
A. That is correct.
Q. And to the present capital structure, isn't that right? A. That is correct.
Q. Now, the fact is that Panhandle Eastern's common stock holders are apparently content to get 11.53 percent

by way of earnings on their common stock, according to your Chart No. 22?

A. That is true as of the date the figure was calculated.

Q. And in Chart No. 26, you use the same capital structure as now exists and you want to make an allowance of 12 percent.

Now, assuming no change in capital structure, how do you justify a figure of 12 percent?

A. Well, I justify it on the basis that I had to calculate throughout for purposes of ascertaining the actual capital requirements, that is, the earnings to meet the capital re- [fol. 6885] quirements, what the figures would be and I accepted a judgment figure there for the common stock which I believe, on the average under those conditions, would be required.

Q. You mean it is your judgment that the average required is going to be something in excess of what is presently required?

A. So long as the trend at that time continued, yes. I think that has already been borne out, as a matter of fact, in the market today.

I do not have the figures but I could produce them on a number of these and I think they show them very clearly.

Q. And that is, you say, purely a judgment figure?

A. That is correct, it is a judgment figure based on the facts studied.

Q. And we have no way of checking the accuracy of that judgment figure by reference to working papers, have we?

A. Yes, you have everything here that I had. That is, in regard to the various calculations made on those five companies and the consideration given to Northern Natural Gas Company and so forth.

In other words, I have not withheld anything here at all. Everything I had to work with you have got.

Q. Now, Mr. Coffman, you show by your Chart No. 21 [fol. 6886] that the common stock holders of Northern Natural Gas Company are content with earnings, after taxes, of 10.38 percent on their common stock, isn't that correct? A. That is correct.

Q. Now, you jump from 10.38 percent to 12 percent by the exercise of your judgment, do you not, for Panhandle Eastern?

A. Not at all. I look at the five companies which show 12.99 percent. That is not a judgment figure. That is pure arithmetic.

Q. That includes Panhandle Eastern doesn't it?

A. Yes; it includes it.

Q. That is pure arithmetic, adding the five and dividing by five?

A. That is correct and the actual at the time of 11.53 for Panhandle Eastern based upon the 1941 market prices and the Northern Natural Gas Company experience, making allowances for the difference in the capital structure between the Panhandle Eastern Company and the Northern Natural and considering the trend at the time.

Q. Now, Northern Natural Gas Company experience is 10.38 percent, is it not?

A. Yes, and its setup is different than Panhandle Eastern's. Its capital setup is different.

Q. Panhandle Eastern Pipe Line Company's figure is [fol. 6887] 12 percent which is strictly comparable with the 10.38 percent, is that right? A. Yes, that is correct.

Q. What are some of the risks of capital that are appraised by the investor?

A. They are numerous. In the first place, the investor, to the best of his ability, tries to secure some idea as to what he thinks the trend of business is going to be like over a reasonable time in the future.

Today, he is wondering what influence the armament and the emergency program is going to have upon business. He is trying to appraise the facts as they become available as to how the war is really turning.

He never fails to take into consideration what the Commissions are doing by way of cutting rates and what influence that might have upon the security of his investments.

He is worrying very definitely about what the Treasury is doing by way of increasing the tax rates and taking more earnings away to finance the present emergency period.

There are, I suppose, just hundreds of different things. To generalize and summarize the thing, the investor, to the best of his ability, is trying to consider all the economic factors that have a bearing upon the security of his investment and a reasonable return thereon, including all [fol. 6888] the things mentioned and a good many others I could mention if you would like.

He looks at the management, for example, and tries to ascertain whether they are efficient or not efficient and whether or not the company is keeping abreast of the times with its service and so forth.

Q. Those things which you mentioned all tend to increase the present earnings price ratio, is that right?
A. At the present time, that is the way it is actually working, as indicated by the trend of market prices.

In other words, today, as we all know, the earnings of many companies are going higher while the prices of common stock are going lower and that is not judgment. That is a matter of fact.

Q. Now, those risks include the possibility of higher taxes, of course, do they not? A. That is correct.
Q. Do they include the possibility of increased expenses?
A. The investor is trying to make an appraisal of that, too, yes.
Q. Do they include the possibility that your theory of rate making will not be adopted by this Commission?
A. I do not know as any investor knows about that, do they?
[fol. 6889] Q. Do they include the possibility of a rate reduction?
A. Well, the investors at the present know that there is a hearing being conducted in regard to this company and, naturally, if they think there is a possibility that some action may be taken by the Commission which will reduce the rates, they will try to appraise the effect of that as best they can and if it is going to jeopardize their position, the presumption is the price of their stocks and bonds will go off.

That can be demonstrated in numerous cases, I think.

Q. And those risks also include, of course, the possibility of other Governmental activities made necessary by the national war program? A. Yes, sir.

Q. Do those risks of capital which are appraised by the investors also include the possibility of a change in earnings?

A. Well, from our experience in advising investors, usually the first two questions that a prospective investor will ask you, or even a man that is already an investor in a particular stock, is what we think the company is going to earn and what do we think it is going to pay.

Mr. Lee: Pardon me. Do you ever advise the prospective investor that if the company's rate is cut, the company [fol. 6890] will sell more gas and make more money? Have you ever advised them that?

The Witness: We point out in cases where they have had increases in output with decreased rates, that that is a fact.

You will find that throughout our services. We have no hesitation in stating that. Wherever it is a fact, we admit it.

Mr. Lee: And the imminence of a cut in the rate does not always lead the investors to be discouraged as you indicated a minute ago. It may be a great benefit to the investors, isn't that right?

The Witness: That all depends on the facts. I can show you in Brooklyn Union, for instance, that is not a fact. It has not protected the investors there by a long shot.

Mr. Lee: That may be an isolated case but, in general, isn't it true that where the public utility service rate is cut —I do not mean a cut that involves a confiscation—but a cut that still has a good earning, results in increased volumes of sales and results in increased earnings, isn't that generally true?

The Witness: Where a company has a growth factor and there are possibilities of further expansion and it is evident there are further possibilities of growth and where [fol. 6891] a reduced rate will, within a reasonable time,

stimulate further usage so that the earnings will be there, the investors try to appraise that also.

They do the best they can with their own knowledge and the facts they have before them and we try to do the same thing.

Mr. Lee: The point I am trying to get at, without any equivocation, is from your knowledge as an expert advisor to prospective investors, you know, don't you, that the cut in public utility rates has stimulated the volume in business and resulted in increased earnings and is a benefit?

The Witness: I can state without equivocation it has been true in the past but it can be demonstrated now, because of changed conditions, that decreases in rates in many utility companies, although it can be absorbed by gross revenue, it is not being absorbed in net revenue.

That can be demonstrated mathematically.

Mr. Lee: But it has been, as I say, in the past, and you will concede that, won't you?

The Witness: Yes, that is true and we have made such admissions in our services.

Mr. Lee: Pardon me for breaking in, Mr. Littman.

By Mr. Littman:

Q. Now, in spite of all of these risks that are appraised [fol. 6892] by the investors which I enumerated and which might seriously reduce or impair earnings, is it your opinion that the investor expects the earnings price ratios to remain stable in the future?

A. Not at all. I have not said that any place throughout.

Q. What do you say about it?

A. I just repeat what I have said about it. As long as conditions remain about as they were at the time of this study, I would say that the result I have stated is a very close approximation to the fact.

Now, if there is a material change in one or more important factors, then I would want to take a fresh look and that is the statement I have made throughout this testimony.

Mr. Lee: Pardon me. Just one more question.

You made a statement that there had been increased earnings but, nevertheless, the common stock sold at a reduced price.

The Witness: I say at the present time, generally, in the market, that is, taking common stocks as a class, that while earnings are advancing or are larger, the common stock prices, as we know, have been going to lower levels.

Mr. Lee: What is the reason for that?

[fol. 6893] The Witness: There are several reasons.

In the first place, although the company is making larger earnings, the investor in common stock can see more and more clearly that the Government is going to take a larger and larger share to finance the war.

Mr. Wheat: Pardon me, when you said, "the company", you were not then referring to Panhandle Eastern, particularly, but just in general?

The Witness: No, I am talking about any company that has a common stock outstanding and the prospective investors or the actual common stockholder today has tabulations before him giving effect to the new tax rates and then perhaps making some estimate beyond that as to what they are likely to go to in view of the statements made by Mr. Morgenthau that 6 percent or 7 percent would be the top allowance and President's Roosevelt's statement to the effect that he does not want to see war profits in this war as against the last one, and so forth, and to the best of their ability, they are trying to evaluate those things and they can see pretty clearly, without knowing the exact amount, that although there may be \$6.00 of earnings a share there, by the time the company gets through meeting all of its obligations, including the higher taxes, there will be little or nothing available for distribution.

After all, that means to the common-stockholder that [fol. 6894] his principal is less secure.

Secondly, his principal is likely not to get any return, so he is not so interested and the consequence is he is just as happy to be out of the stock as to be in it and the price

keeps going off. It is a seller's market rather than a buyer's market.

By Mr. Littman:

Q. What happens to the stock when the investor begins to worry about all of these things you mentioned?

A. If he worries enough so that there are more people attempting to sell than there are buying, the price goes off.

Q. The price goes down and the earnings price ratio goes up?

A. That is correct.

Q. And that is simply because the investor knows that next year he is going to have to take a cut in his earnings price ratio, is that right?

A. No, the reason for that is that he knows that someplace along, if his interpretation of the facts is correct, the earnings available for distribution will be less and, therefore, it is a question of whether he wishes to hold them until the storm blows over or whether he gets out.

In any event, if he will do any new financing, he will [fol. 6895] have to do it on that basis. Otherwise, the people would be holding their common stock.

Q. In other words, he is, in his own mind, discounting his present earnings price ratio by what he expects to occur in the future, is that right?

A. He is giving some weight to that because it is his money, obviously, and he is trying to protect it.

Q. Well, assuming that brewery stocks were on the market at the time when prohibition was imminent, what effect would the imminence of prohibition against the sale of spiritous brews have upon the price of the common stock of that brewery?

A. Well, it would have a very disastrous effect.

Q. Tell me what would happen to the earnings price ratios?

A. The earnings at that given time would be the same, obviously.

Q. The same as what?

A. The same as they were. I mean if you are talking about June of 1940 and to that date there were so many earnings per share but by December everyone knew the

Act was going to pass and there would be no more, there would be a big rush to buy brew, so the earnings would be tremendous but, nevertheless, the price would go off because the man wants to get his capital out of the hands [fol. 6896] of that particular outfit before it goes broke.

In other words, he wants to save his money. He earned it and he worked hard to get it and he wants to keep it.

Q. So the price earnings ratio would go way up?

A. Temporarily and then they would go to pot.

Q. They would go to pot?

A. That is right.

Q. And that is simply because the investor knows that next year he is not going to be able to make any earnings?

A. Not only that but he may not even get his capital back if he does not get it back now and that is what he is worried about in all of these companies.

Q. Now, if an investor in a natural-gas pipe-line company's stock was fearful that within the next six months there would be a cut in rates, what effect would that have upon the earnings price ratio?

A. Well, to come back to the other gentleman's question, if the investors thought that the imminence of a rate reduction or actually knew that a rate reduction was to take place but, at the same time, knowing the company, believed it had a growth factor—to make my answer simple—if he believed that the growth factor would supply additional earnings net to offset the loss of earnings by virtue of the rate cut so that he was, for all practical [fol. 6897] purposes at status quo, not at a given moment of time but at a reasonable period of time, he wouldn't be disturbed.

Q. I am asking you to assume that the invester was satisfied in his own mind that a rate cut was imminent within six months.

What effect would that have upon the earnings price ratios?

A. Well, the answer I have just given answers that question.

Now, if you wish me to go on and assume that that rate cut is actually going to cut net earnings and he knows that equally well—may I make that assumption?

Q. Yes, he knows that.

A. Then the likelihood is that he will say that he is not as sure about the safety of his principal in that security in that company as he was before and the price will go off.

Q. Therefore, he will want, for instance, 12 percent, let us take that as an example?

A. As against something lower before.

Q. And he wants that 12 percent because he knows that six months hence it is not going to be 12 percent any more, it is going to be something less than 12 percent, isn't that correct?

[fol. 6898] A. He is fearful of that and he is fearful that his principal is no longer secure.

Q. I am asking you to assume that he knows that.

A. My answer is the same. He knows that. The price is going off, because it is becoming a riskier business from the standpoint of his investment and he requires more in the way of return to accept that risk.

Q. Now, he requires more for his rate of return?

A. Or so long as the conditions existent now remain.

Q. And he is perfectly content to take the 12 percent today, knowing that it will be, let us say, 10 percent or 8 percent by reason of a rate reduction six months hence, isn't that correct?

A. He is still talking in terms of the average. That is, what he can sell over a period.

Q. And the answer to my question is "yes"?

A. With the statement that it covers a period of time on the basis of what I have said before.

Q. Now, the investor who knows that increased taxes will have the effect of cutting down his earnings six months hence goes into the venture at 12 percent knowing and being content with something less six months hence, isn't that correct, by reason of the cut in taxes?

A. He will go in if 12 percent is the figure. It takes [fol. 6899] that much to invite his capital, yes.

Q. And, six months hence he will, in all probability, be receiving something less than 12 percent by reason of these various risks that are in his mind, isn't that correct?

A. No, you cannot say that directly because there, you see, you are again complicating two factors.

If the earnings are going down and he is fearful the price will go down, now, the relationship of how the two decline will determine whether it is 12, 13, 11 or 15. I do not know.

Q. But every risk in the mind of the investor causes the present earnings price ratio to go up, doesn't it?

A. If it is converted to selling the stock, it will be driving the price down.

Q. And the reason for that is simply because the investor is discounting for the future, is that right?

A. Yes, he has to safeguard his capital, yes, absolutely.

Q. So the investor who is demanding, let us say, 12 percent today may, in all probability, be doing that simply because he knows that he will receive something less in the future and is perfectly satisfied to receive that lesser amount in the future?

A. If he believes that the risk, as he appraises it, is, [fol. 6900] to the best of his judgment compensated by a 12 percent ratio, yes.

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[fol. 6903] Paul B. Coffman a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Cross-Examination (Continued)

By Mr. Littman:

Q. Mr. Coffman, at the close of yesterday's session, we were discussing the matter of the investor's appraisal of risks as indicated by the earnings-price ratios.

Have current prices of utility common stocks been influenced by a notion that original cost may be substituted for reproduction cost in the rate-making process?

A. Mr. Littman, I do not know as I could say whether the price had been influenced or not. I think, from my observations, that this much is true:

Investors and prospective investors as well as investment advisory firms naturally have been following the trend and, in so far as work which has been done before Commissions and this Commission is concerned and dis-

cussions regarding original cost and cost of reproduction new, I presume it has been a part of their thinking but, whether or not to this date that has been converted tangibly to any change in price, I do not believe I could pass upon [fol. 6904] that. I do not know. I know they are aware of it but whether or not it has had an effect upon price, I cannot say.

Q. In your opinion, Mr. Coffman, would an investor who is considering the relative merits of common stocks take into consideration prospective changes in the earning power of the various corporations whose securities are under consideration?

A. Yes, he would.

Q. Is it a fact that investors are more interested in prospective earnings than in past earnings?

A. Yes, I would say that is true and if I may explain more fully, when a security changes hands the present owner has already had the benefit of the earning power in so far as the share he holds is concerned.

The prospective purchaser, on the other hand, has no benefit as to what has happened. He is looking forward as to what he will and how he will benefit after he purchases the security.

Q. So we may agree that investors are primarily interested in prospective earnings?

A. Generally, that is true.

Q. I read from the Standard Outlook for Security Markets, issue of April 8, 1940, published by the firm of which you are a Vice President, namely, Standard and Poor's, as follows:

[fol. 6905] "A high yield is not of itself an indication that a stock is attractive. It may signify that the dividend is vulnerable—the dividend payments are not being covered by earnings or that earnings' prospects do not promise continued coverage for any length of time."

Do you agree with that statement?

The Witness: May I have that re-read, please?

(Whereupon, the portion indicated was read by the reporter.)

The Witness: In the first place, the excerpt that you have just read from our service is now talking about a yield as against earnings-price ratios that we have been talking about.

I want to make that point clear so that what I say will be directed to a yield, as such, and not a price-earnings ratio.

Q. You are now referring to a dividend?

A. That is what is being referred to there. When we talk about a yield in that particular publication, as it is used, we are referring to a yield and on that basis, I would say that the statement you have quoted [in] generally correct.

Q. Do you disagree with it ~~in any particular~~?

A. No, I say it is generally correct. We could be more definitive if we wanted to go on but, as far as it goes, it [fol. 6906] is an accurate statement.

Q. Would this statement also be applicable, in principle, to earnings-price ratios?

A. It would generally apply to this extent that, as an earnings-price ratio goes up, there is at least an indication that investors believe that the risk of the particular business has increased or, to use the term that is used there, it is somewhat more vulnerable, referring, of course, there to dividends.

Q. In other words, a high earnings-price ratio would not, of itself, be an indication that a stock is attractive?

A. Not necessarily. You would have to make an analysis to ascertain that fact.

Q. In other words, it is true that a high earnings-price ratio is not, of itself, an indication that a stock is attractive?

A. That is correct.

Q. And is it also true that a high earnings-price ratio may signify that the earnings' prospects will not continue at the same level for any length of time, to paraphrase the statement?

A. It may well indicate that.

Q. In your opinion, would an outlook for decreased future earnings tend to increase or decrease current [fol. 6907] earnings-price ratios?

A. Well, if you are talking about a single company for the moment as against an over-all group and the earnings-price ratio were to go up because the earnings' prospect looked more dismal, I would say the [the] earnings-price ratio changed because of the possibilities of that change in earnings, that adverse prospective change in earnings.

Q. Would that be true in the case of a natural-gas pipeline utility that was facing a rate reduction?

A. It could be true.

Q. It would be true, wouldn't it?

A. Not necessarily.

Q. All other things being equal and giving weight to that element alone, it would be true, would it not?

A. Well, it might, only temporarily, Mr. Littman. The reason I qualify myself is because of an answer I believe I gave yesterday on the same subject, namely, that if you have a natural-gas pipe-line company or, for that matter, any other company which shows a high growth factor wherein it can be demonstrated or reasonably assumed that a reduction of rates may well stimulate business so that the aggregate number of dollars coming in remains the same or a little larger so that the net income is about maintained, there would only be, I should say, a temporary reduction in the earnings-price ratio.

[fol. 6908] I merely want to point out it is not as simple a thing as you state. There are growth factors to be considered and other factors, all of which will be weighed to the best of the investor's ability.

Q. Your statement would indicate that a rate reduction, in an investor's opinion, can only be made up by future increased business?

A. Yes, if you eliminate that factor and say that the rate reduction coming through is to make a permanent impairment in earnings, then I think the earnings-price ratio would likely register that by showing an increase.

Q. And that is the very thing that an investor is fearful of when a rate investigation is commenced, isn't that correct?

A. Yes, especially if he has got a wide interest, he will begin to pay pretty close attention to see how the situation is going on the score that the money is still

his and it is his option whether he would rather have it there or place it elsewhere and he tries to find out that factor by weighing the relative risks.

In other words, a man that has earned and saved capital and has it invested is always looking at the security of it, as [wells] as the return.

Q. In other words, the investor is rather sensitive on the subject of the imminence of a cut in his earnings when [fol. 6909] an investigation of the rates of a particular utility is launched, isn't that correct?

A. Well, you say "sensitive." That is a little hard to use. I would say that he is very definitely appraising these things with the sole purpose of trying to ascertain whether or not his capital will be preserved.

I do not know that he is any more sensitive to a rate investigation, let us say, than he might have been to the Pearl Harbor episode and the fact we were going to be short on rubber, tin and a few other things from the Far East as it might have affected a rubber company, let us say, and he is sensitive to that, too.

Q. Assuming that this investor knows that gross revenues are going to increase through normal growth in the future and if there were no rate reduction imminent, what effect would that have on the earnings-price ratio?

A. Well, say all other things being equal, it would tend to lower the earnings-price ratio as in comparison to the preceding illustration [your] gave.

Q. Now, if we inject in that situation the imminence of a rate reduction that would, of course, raise the current price ratio, would it not?

A. It would tend to do that because that is an added risk, absolutely. There is more hazard.

Q. If an investor believes that prospective earnings [fol. 6910] will be lower than current earnings, would that fact tend to raise or lower the market price of common stocks?

A. Well, if the prospects were that the earnings would be less, it would tend, other things being equal, to lower the price.

Q. And in that manner, of course, increase the current earnings-price ratio?

A. Based upon the then present earnings, yes.

Q. Have you anywhere in your study shown the prospective earnings of natural-gas pipe-line utilities which you used as a basis of comparison with Panhandle Eastern Pipe Line Company?

A. No, I do not have such figures in this exhibit but, as you know, from time to time in our various printed services, we are making estimates on numerous companies, at least those that are more interesting to the investor.

Q. Has your company, Standard and Poor's, made a survey of Panhandle Eastern Pipe Line Company?

A. Well, it depends on what you mean by "a survey." If you mean, do we comment on the company and its securities, yes, we do.

Q. You referred to such a survey in your testimony in the David Young III case, did you not?

A. No, I did not. Mr. Payer did and had some short written letter in which there were general comments about [fol. 6911] the historical background and so on. I never saw the document myself.

Q. You do know of such a survey, do you not?

A. I do, from the fact that Mr. Payer said he had one in his hand and read from it, although he would not give it to me to look at.

I assumed he was not lying but actually did have such document and was putting it in the record, according to its caption.

Q. You have never studied that survey?

A. No. At the time the case came about, I did not even know of its existence.

Q. Have you studied it since that time?

A. I have studied one particular section which was the particular part that Mr. Payer was referring to, yes.

Q. Will you be so kind as to let me have a copy of that survey and any recent or more recent surveys of Panhandle Eastern Pipe Line Company that have been published by your company?

A. I am sorry, I could not do it on that particular one because I was never able to find a copy of the thing in our files.

It is not a printed document. It was never published. It was not one of our publications.

You see, some analyst in our shop was approached by [fol. 6912] some man from the outside with some figures and the gentleman at that time said he wished we would take the figures, as analysts, and see how we would put them together. That is what he did. They were not our figures and we did not know the use to which they were to be put. It was just a letter—

Q. (Interposing) A letter addressed by whom to whom?

A. By this analyst. As a matter of fact, I do not think it actually carried a signature. I cannot say. I did not see the whole thing but I searched high and low in our files to get a copy so I could see it myself, since Mr. Payer would not let me have his copy and he did not, as you know, put that in as a matter of record. He refrained very diligently from doing that.

I could not get a copy. There is no copy in our files and the people who did the job are apparently no longer with us and I never could find out what the thing was all about.

Q. For purposes of identification in the record, Mr. Payer was one of the attorneys for the plaintiff?

A. That is correct.

Q. David Young III?

A. David Young III, that is correct.

However, on the rest of your question, any publications that we have covering Panhandle Eastern Pipe Line Company, I would be very happy to send you; but that was not [fol. 6913] a printed document.

[It] it was, I could very easily get a copy or a photostat copy.

Q. Assume, Mr. Coffman, that the earnings-price ratio of a particular common stock, based on earnings for the latest available fiscal year is 11.53 percent and assume further that the investor is aware of or has been advised of the following:

First, that an increased cost of operating and maintenance amounting to at least 10 percent of such cost was likely to be incurred in the future;

Assume secondly, that some increase in State, local and miscellaneous Federal taxes is expected;

Assume thirdly, that Federal income and excess profits taxes based on the 1941 tax rate would be more than $1,000,000 greater than on the 1940 tax rates;

Assume fourthly, that the management of the company expects a still further increase in Federal taxes in 1942 of 10 percent;

Assume fifthly, that the depreciation, depletion and amortization allowance made by the company during the last fiscal year is inadequate, in the opinion of one of the company's experts, to return the invested capital when the reserves are exhausted;

Assume sixthly, that the Federal Power Commission was [fol. 6914] currently holding hearings to determine whether the rates of the company are reasonable or unreasonable and, if found unreasonably high, would in all likelihood reduce such rates.

Now, assuming these six items which I have named, if the investor knew or had been advised of these circumstances, could he reasonably expect that an earnings-price ratio of 11.53 percent would be maintained on the common stock during the succeeding year?

A. I would not think so.

Q. You would not think so?

A. No, but, as I have stated in my testimony right along, he is not looking at it for a single moment of time or a single year.

He is talking about over the average. In other words, he did not buy his investment today to liquidate it next month or next year. He bought the investment to let it stay put.

If it averages out over the years, he will feel he has fared all right and the principal was safe and the income on it reasonable.

Q. Under the conditions that I have assumed, would the investor expect the 11.53 percent earnings-price ratio to obtain throughout the year 1942?

A. That would all depend on conditions at the time. If all the conditions were adverse at the time, the given mo-

[fol. 6915] ment of time you are speaking of, then I would say that throughout the remaining months we would not expect it to be maintained because the price might be sliding off gradually.

If there were other factors which would tend to offset part of that it might, for the most part, be maintained, but over a period of time, with these assumptions you have made, it would not be.

Q. I am talking about the year 1942 when I asked you this last question.

A. Conditions existing as we know them to be right now at this time, January 28, 1942, making the assumptions that you have asked me to make and viewing the external conditions as I view them, which also have a part to play in this price, I would not suppose that it would be reasonable to expect the earnings-price ratio to remain at 11.3.

I think for the moment it might be higher.

Q. 11.53 is the figure.

A. I am sorry, 11.53. I should suppose it might be higher. Later, as the rate reduction goes into effect, if it proves to be an actuality and the taxes get higher so the earnings are lower, then the ratio will tend to go down.

How much, will depend upon the relationship of decline between the price, on the one hand, and the decline or [fol 6916] earnings on the other.

Q. You mean the earnings-price ratios might, under these circumstances, go down to 6 percent, might they not, in 1942?

A. It is hard to know how low they will go. If it gets too low, you would not have any investors in the business at all.

Q. But it will go lower and it will go considerably lower, will it not?

A. When the earnings drop off materially, the price will also drop. Now, where that will rest, as I say, depends upon the relationship of the decline between the two and I think it is well to point out in this connection that you are really talking about two confusing things.

In the first place, you are talking about a present earning against a prospective eventuality. The earnings today,

for example, we will say, are $3 a share. The prospect may be $2 but, so far as this year's earnings are concerned, upon which you compute the ratio, you use $3 until the next annual or quarterly or semiannual statement comes out when you can get a new look.

Q. Is what you have given as your last answer the same in substance and does it comport with the testimony which you gave in the David Young suit?

A. I have not read the David Young suit in a couple [fol. 6917] of years, 1939, or whenever it was, but it is consistent with the part of the David Young suit which you read, very definitely.

Q. It is consistent with your—

A. (Interposing) I say it is consistent with the David Young suit, that part of my testimony in the David Young suit which you read. Beyond that, as I say, my memory is not fresh on it but I think it must be the same because I do not believe I have changed my opinion from that time to this in regard to reaction of investors to changes in price and earnings.

Q. You have at least changed your opinion on the worth of market quotations since you testified in the David Young suit?

Mr. Wheat: Is that a question or a statement?

Mr. Littman: It is a question.

The Witness: I do not know that I have.

By Mr. Littman:

Q. You do not think you have?

A. No, I do not think I have.

Q. Did you rely on market prices of stocks in the David Young suit in connection with your testimony on Panhandle Eastern's common stock?

A. No, I did not in that case because there the question was one of trying to determine the fair value.

[fol. 6918] In this particular case, I think I have only said or have solely said that I used price quotations in every instance where they were available because they were the only guide available at the time as to what two independent parties thought about the price of that security.

Q. Do you recall testifying in the David Young suit that the market quotations of Panhandle Eastern's com-

mon stock were wholly unreliable for purposes of relating earnings, dividends and for use in—withdraw that—.

It is a fact, is it not, that you disregarded the market quotations of Panhandle Eastern's stock in your testimony in the David Young suit, is that correct?

A. In regard to the particular security?
Q. In regard to the common stock.
A. Yes, that is correct.
Q. Why did you disregard those market quotations in the David Young suit on the common stock of Panhandle Eastern?
A. Because, in that particular case, the question was one of determining fair value for all the stock and, therefore, I used an earnings-evaluation method to determine it, which I believe to be one sound method and that is in no case in conflict with anything I have said here whatsoever.
Q. Coming back to the question of earnings-price [fol. 6919] ratios, Mr. Coffman, I want you to assume the following:

First, that the investor had been advised that Panhandle Eastern Pipe Line Company had been held to be a subsidiary of a large holding company by the Securities and Exchange Commission after contesting such a finding;

Secondly, that the company was involved in long and costly litigation;

Thirdly, that it was being prosecuted in an anti-trust case;

Fourthly—

Mr. Culton: (Interposing) Panhandle Eastern was being prosecuted in such a case?

Mr. Littman: I am asking him to assume that a company was being prosecuted in an anti-trust case.

Fourthly, that rate hearings were being held before the Federal Power Commission;

Fifthly, that the company had been named in integration proceedings against its holding company by the Securities and Exchange Commission.

"Now, what influence would these matters have upon the current-price ratio of that company?

* * * * * * * *

[fol. 6920] The Witness: All other factors remaining the same and taking into account these five items, the five hypothetical assumptions that you have asked me to make, it would be likely that the investor would, to the best of his judgment, attempt to ascertain what the likelihood of the outcome of some of these hearings and suits would be and, to the extent that he thought there might be some action taken in one connection or another with these five items, the price of the security would tend to decline, in which case the earnings-price ratio would go up, based upon the then-present earnings.

* * * * * * * *

[fol. 6921] By Mr. Littman:

Q. Now, where you use the earnings-price ratio of this hypothetical company concerning which I have asked you a number of questions here and a moment ago, I think I asked you to make six assumptions first and then five.

We have eliminated one, making 10 in all. If you were using the earnings-price ratios of this particular corporation as a guide for the determination of the current cost of capital, of course, your guide would be very likely to give you a higher rate of return or dollar return for the present than is clearly indicated by the future, isn't that correct?

A. All other things being equal, that would tend to be true for the period about which you are talking.

I do not mean by "period" a future period. I am talking about the time you are talking about when you have those earnings available and these particular conditions only. I [fol. 6922] do not mean to be misinterpreted by saying "period" that you are interpreting that, that it means a period of years. There is no such thought in my mind.

Q. Well, of course the earnings-price ratio is taken as of the present. You are assuming that, aren't you?

A. Both factors of the earnings-price ratio are being taken as of the present, the earnings which you have available as reported on the last available financial statement—

Q. (Interposing). Yes, you are assuming that—
A. (Continuing) Yes, and the price quotation at the time.

In our particular study, as you know, to avoid any odd day in the market, we used average prices over a period of months so that if one day in the market happened to be out of line, it would not distort in any way the calculations.

Q. Yes. Well, assuming that the earnings-price ratio was calculated as of the period for which you calculated your earnings-price ratios for the year 1941 and assuming these ten conditions which I have asked you to assume, I am now asking you whether a rate of return or a dollar figure of return based upon the earnings-price ratio which results from these ten ominous factors would be too high to be used in the future, all things being equal?
[fol. 6923] A. That is inconsistent on its face, isn't it? If all things remain the same, it seems to me—
Q. (Interposing) All other things remain the same.
A. In other words, all external conditions and everything else remain the same except the ten points—
Q. (Interposing) Except the ten assumptions, that is right.
A. Well, in so far as the prospective investors or the actual investors in the security gave weight to these ten factors and the price of the security declined, there would result, all other things remaining equal, a higher earnings-price ratio.

Now, if you took that amount, that rate that you get to determine the dollars which you are talking about, which, as I interpret it, to get down to Exhibit 65, Chart 37, is the $5,064,821, it would be higher but the point is that as of the time the study was made and so long as these conditions are as they are, I contend that the investor will require that earnings-price ratio before he will be willing to increase his capital in the business.

If you eliminate any of the hazards, the business becomes more certain, his capital becomes more secure, more certain, the earnings-price ratio will change. The market has changed and investors will look at it differently.

Q. Now, Mr. Coffman, the first six assumptions which [fol. 6924] I asked you to make all appear in your Exhibit No. 65, do they not?

A. Well, No. 1, increase in operations and maintenance —10 percent, that is correct. Some increase in taxes is correct.

Q. Now, are you talking about State, local—

A. (Interposing) State, local and municipal taxes. Federal taxes, more than $1,000,000—well that, I do not recall the specific figure, but that is approximately correct as shown in Exhibit 65, chart—

Q. (Interposing) Table for chart No. 30?

A. As shown in Chart No. 30.

Tax, more than a million dollars larger, all right. It is about $1,000,000,—well, I cannot make that.

Taking all taxes together, if you will, for the moment, it is more than $1,300,000. That includes the State, local and miscellaneous and the Federal income and excess profits.

Q. That would take care of the fourth assumption that I made, that is, an additional 10 percent increase in Federal taxes for 1942, as shown by your Chart No. 30 of Exhibit 65, isn't that correct?

A. I am apparently getting a little mixed up with you. I thought that your second item was some increase in taxes which was State, local and miscellaneous and three was Federal taxes, more than a million dollars; and fourth [fol. 6925] was management expects larger taxes. I did not know you had put any particular percent or otherwise on a dollar figure.

Q. I assumed that was the percent that you show in Chart No. 30—

A. (Interposing) Yes, all right.

Q. (Continuing) Which is called, "Allows further 10 percent increase in Federal taxes."

A. All right.

Q. How about the fifth assumption, that the depreciation, depletion and amortization allowance taken by the company during the last fiscal year is inadequate?

A. Yes, we show a difference on that, the figure I used being higher.

Q. And the sixth assumption is, of course, correct. We are holding the hearing to determine the reasonableness of rates.

A. Yes.

Q. So those six assumptions are in accord with your Exhibit 65, are they not?

A. That is correct.

Q. How about the last four assumptions? You know, do you not, that Panhandle Eastern has been held to be a subsidiary of Columbia Gas & Electric Corporation, do you not?

A. Yes, sir.

* * * * * * * *

[fol. 6926] By Mr. Littman:

Q. Are you familiar with the litigation involved in Panhandle Eastern?

A. Yes, I am—the David Young suit, you mean?

Q. Yes. A. Yes, I am familiar with it.

Let me be sure. You were not asking me if I thought Panhandle Eastern was a part of that suit. You asked me if I was familiar with the David Young suit, is that correct?

Q. Yes.

A. I am familiar with that suit, without saying whether Panhandle Eastern or anyone else was mixed up in it.

Q. Exhibit No. 145 sets forth a number of suits—

Mr. Wheat: (Interposing) For the witness' benefit, you might identify what the exhibit is, Mr. Littman.

[fol. 6927] Mr. Littman: I was just going to hand it to him, Mr. Wheat.

Mr. Culton: On Page 12, it shows Columbia Oil and Columbia Gas as defendants.

By Mr. Littman:

Q. This Exhibit No. 145 is the Panhandle Eastern Pipe Line Company compiled Registration Statement covering issues of $10,000,000 first mortgage and first lien, 3 percent bonds, Series C, due January 1, 1962, and 150,000 shares of (blank) percent cumulative preferred stock filed with the S. E. C. on December 24, 1941, and called "Registration Statement No. 2-4919.["]

Now, this document sets forth certain litigation in which Panhandle Eastern has been involved or, at least, which touch upon the issuance of securities by Panhandle Eastern. Otherwise, I assume that would not be mentioned in that statement.

From your knowledge of the company, Mr. Coffman, are you disagreeing with the statement that Panhandle Eastern Pipe Line Company has been involved in long and costly litigation or is that a correct characterization?

A. Well, it is a little hard for me to answer that, Mr. Littman, because when you say "long and costly", in the first place, I do not know what the costs were.

I know that there was the David Young suit, all right. [fol. 6928] As a matter of fact, I do not know just how many months that took or what else followed it. I am not in a position to state. I will say I know about that suit, but when you say "long and costly litigation", I have not anything to go on at the moment.

Q. Well, what about the next assumption?

A. That is the present rate hearings that are being held, that is the same as No. 6 above; and the next item which is now No. 4, the company had been mentioned in integration proceedings, that is true.

Q. Then the only one of these ten assumptions that you are not personally certain about is the one in which I had you assume that the company had been involved in long and costly litigation, so I will just ask you to eliminate that one.

The nine other factors, of course, would tend to increase the earnings-price ratio beyond that which would have been otherwise shown in the absence of those items?

A. Yes, at the time you are making this particular calculation, that is, and that is prior to any of these taking actual effect.

Q. And the earnings-price ratio which reflected these elements, as well as the other elements extant at the time was 11.53 percent for Panhandle Eastern, is that correct? [fol. 6929] A. That is correct.

Q. That is the 1941 percent?

A. Yes—well, to make it specific, using the earnings figure stated in my exhibit and the price of the security shown, yes.

Q. And you are now referring to your Chart No. 22, to be certain about it? A. Yes, that is right.

Trial Examiner: Mr. Coffman, leaving the hypothetical questions for a moment—

Mr. Littman: (Interposing) By the way, I might state at the moment, Mr. Examiner, I have just asked the witness whether all of these hypothetical matters are facts and, with one exception, he has stated they were.

Trial Examiner: And have been reflected in the ratios discussed?

Mr. Littman: Yes.

Trial Examiner: And he has said they are.

Mr. Littman: That is right. I am sorry to have interrupted you.

Trial Examiner: Eliminating the various hypothetical aspects which you have been discussing you, of course, are closely familiar with the various appropriation acts of the Congress since your study was originally prepared?

The Witness: Yes, I am aware of them. You are referring [fol. 6930] now to those matters particularly related to budget?

Trial Examiner: The obligations of the Nation.

The Witness: Yes, that is correct.

Trial Examiner: Are you able to state what the prospective national debt will be at the end of 1943?

The Witness: Well, I believe the most recent estimates that have been made would indicate that the national debt at that time will be in the neighborhood of one hundred and fifty billion dollars.

Trial Examiner: Your exhibit relating to the effect of the Act of 1941 on taxation of the Panhandle Eastern Company, numbered for identification as 152, contains a quotation from the New York Times in which the Secretary of the Treasury is quoted as predicting the necessity of a

100 percent tax on corporate gains over 6 percent at some time in the near future.

The Witness: Yes, sir.

Trial Examiner: It is, of course, proper to assume that whatever tax legislation may become necessary to maintain the credit of the Government will apply to all enterprises alike?

The Witness: Yes, it would seem to me that it would.

Trial Examiner: In view of these economic considerations, do you feel that the data, the factors and the financial history reflected in your Exhibits 63, 64 and 65, may [fol. 6931] still be accepted with confidence in appraising the demands of future private investors?

I mean in the immediate future, in the future of the next five years.

The Witness: Well, Mr. Crosby, I thought I had, throughout my testimony, made it clear that the statistical data that I have presented in these three exhibits, Nos. 63, 64 and 65 would hold good and be of use so long as the conditions surounding the date of this study held reasonably the same.

Now, if because of the emergency or some other event the conditions would change radically so that these data would be altered radically, then I would want to review the entire situation and refresh or freshen my point of view and it might be that those changes in data would very definitely lead to a change in the final result.

If they did, I should follow this same procedure to arrive at that result. In other words, as new facts come to bear, I would very definitely wish to look at them and I think the Commission does too and I would do that to the best of my ability.

Trial Examiner: Have not facts just referred to now become realities, with the exception of the ascertainment of the exact method and rate of taxation?

The Witness: If I understand you correctly, what you [fol. 6932] mean there is—

Trial Examiner: (Interposing) The size of the national debt.

The Witness: Yes.

Trial Examiner: The necessities which we all recognize to maintain the credit of the Government, the inevitable effect of these conditions upon all private investors; must we not accept these things as the realities of today and are we deluding ourselves when we continue to rely upon the data which heretofore has proven more or less accurate and reliable?

The Witness: I do not believe that is true, Mr. Crosby. Without question, there will be many changes but, nevertheless, private investors still exist and will be relied upon from time to time, as they are apparently, to buy various kinds of securities or to finance various kinds of enterprises so that you find today people buying Defense Bonds, as well as buying other securities.

Part are to finance the war and part to finance business, and that will continue, I should think, unless the emergency becomes so serious that all such matters as that will have to be stopped.

Assuming that the latter does not happen and that we go on as we have been but taking cognizance of these economic changes, there will arrive a point where the rela- [fol. 6933] tionship of earnings and security prices will be such that the investor, to the best of his judgment, will say that he has pretty much discounted about all of this adverse situation that he can see.

Now, it may be, for example, that the market has arrived at that point now. I think it is rather to be noted that after Pearl Harbor which, I think to most of us was most unexpected, the market held itself pretty well.

There was a decline but it did not become panicky and yet the Securities and Exchange Commission, I believe, at that time was ready to close the Stock Exchange at a moment's notice if it got unruly, which would indicate to me that investors at that time had felt they were pretty well right in discounting these things that were going to happen and one did happen, even though we had not ex-

pected that particular one, but it did not shock them or jar them too much, so I believe you arrive at the point here where you pretty well successfully discount these matters and, at that point, it begins to stabilize.

Trial Examiner: When will that point be reached, in your opinion? Of course, I am not anticipating that you can give a date but what must occur before it can be reached?

The Witness: Well, I would suppose that so far as our war activity was concerned, we would have to wait until [fol. 6934] it became pretty definitely established in people's minds that we were at that date caught up with this war situation so that we, at least, had an even balance of power and were enjoying, from time to time, one or two notable victories as against being caught in a tragic situation like Pearl Harbor and having oil tankers sunk at random off the Atlantic Coast.

Whether we will be prepared to accomplish that by 1943, I do not know although I believe President Roosevelt and some other high Government officials have indicated they believe that our preparedness would be such in 1943 that we would be able to cope with practically any situation.

If that happens in 1943, I would say that is about the date people then would begin to get a little more confident and would be a little more reassured and we would begin to turn our thoughts to ultimate victory even though it were sometime after 1943 and I will say this, Mr. Crosby, I think an analysis of what has gone on in many years in the New York Stock Exchange will indicate that investors as a group have been pretty good in discounting what was going to happen.

I think an analysis of the market will show that very clearly over the years. Very seldom have they been wrong, even as to depressions and return of prosperity, added regulation and so forth.

[fol. 6935] In the Street, they usually describe it by that old saying that "fifty million Frenchmen can't be wrong", and I think there is something in it.

[fol. 6936] Trial Examiner: Back of these questions was the basic wonderment whether the old data have been so

seriously disturbed that your present predictions were made with less confidence than they would have been, for instance, at the time you prepared these reports and studies.

A. Well, it is true that more disturbing things have happened to this date than had happened at the date of preparing the report but, as I say, from, well, let us say, from Munich the market has been anticipating something. We didn't know just when it was going to come, but the market pretty definitely had been saying that sooner or later we were going to get into the war and prices have gradually been declining, slowly but surely, anticipating that hazard. Now, as I say, whether or not it has arrived at a level where practically any bad news is discounted so that there would be only the most fractional change in prices, I don't know, but we arrive, as you go in this decline, at a point where practically all the risks have been discounted and then from there on it depends upon the news on the favorable side to begin to lift it up.

Trial Examiner: Is it proper to infer from your inclusion of Mr. Morgenthau's statement in your exhibit marked for identification Exhibit 152 that among these things the market has anticipated is a sharp and vigorous limitation of all the profits of private investors?

[fol. 6937] The Witness: Well, of course, it is a little difficult to say. My impression of what the investor, the general investor has done to date is that he has pretty much thought that there are going to be higher taxes, but he has felt that it would be quite a while before we got down to Mr. Morgenthau's idea, so that the only purpose of my putting that statement in was to show that that is the kind of evidence that the investor is getting from time to time in the press and from other places, the various letters that are sent out discussing these matters and although the investor may not agree that we are ever going to go to quite that limit, at least not in the next year or so, it does indicate that the Secretary of the Treasury feels that we have got to have more money to finance this emergency.

Trial Examiner: Mr. Coffman, is it not an inevitable consequence of our present economic condition as a nation, as a government?

The Witness: That we come to a limitation of 6 percent?

Trial Examiner: That we come to such a low limitation of profits. In other words, it will affect the confiscation of earnings above a fixed moderate maximum in some form and by some means.

The Witness: It may well be, but in working out taxes there is a happy balance as to how far you can go to get [fol. 6938] maximum revenue. In other words, you take various kinds of companies that are earning money, if they are permitted, under the various Government contracts that are let, an opportunity to make money so there will be taxable income, it may be that there is a point there where there would be a larger aggregate tax collection than if we squeeze so much out that even if you took all the earnings there wouldn't be as much left, because, after all, the earnings that are being taxable, whenever you get into an emergency like this, for all practical purposes, is a loan on future capital. In other words, the way you let the defense contracts out is because you are going to sell Liberty Bonds, and so on, to finance those present contracts which, in turn, show earnings which you tax, so that the debt that is outstanding, presumably, will have to be paid off sometime, or if the emergency is so great that we find it can never be paid off, that is where you get then not only a confiscation of earnings but you get an absolute confiscation of capital and it may well come to that, but I don't know, and I don't think people in this country think so, I mean investors have not gone that far.

(Thereupon a short recess was had.)

By Mr. Littman:

Q. In response to the Trial Examiner's inquiries, you spoke of the market having anticipated the war and that [fol. 6939] when the war came it came as no particular shock. Now, isn't it a fact that the market has also been anticipating these elements which I have asked you to assume and which you have stated were correct assumptions with respect to the investors' appraisal of risks?

A. Yes, I think the investors have been, also, discounting these factors that you mention.

Q. So that if and when a rate reduction comes, that won't be much of a shock to them, either, will it, inasmuch as they have been and are now anticipating and discounting that possibility?

A. Yes, I would say that to the extent that the investors in regulated companies have already discounted these eventualities, there will be less shock shown than if they had not discounted any at all, yes.

Q. In your Exhibit 152 you show on the last page a statement made by the Secretary of the Treasury, Mr. Morgenthau, which is copied from the New York Times, is that correct?

A. Yes, that is correct.

Q. Now, in the first paragraph of that statement, there is a reference to corporations' profits over 6 percent on "invested capital". Can you define the term "invested capital" as it is used by Secretary Morgenthau in this statement?

[fol. 6940] A. I am not sure that that phrase "invested capital" has been fully defined. I say that for this reason: Corporations now having to file an excess profits tax return along with their regular income tax return have been given the option to date of whether they will compute their credit on the basis of average earnings as defined in the 1941 Act or beginning in the second Revenue Act of 1940, as a matter of fact, or whether they will compute their credit on the basis of invested capital. Now, I believe it is true that some companies who have not established an invested capital base which was accurate or a good approximation of what the Government had in mind under the Act, have been trying to rehabilitate their accounts to establish an invested capital account. In those cases there have been a number of changes because certain corporations over a period of years, for example, were formed by consolidation of companies and at the time of consolidation prices were paid for the securities or assets of the company which involved a payment for good will, as one example. The companies, subsequent to the date of the consolidation or merger, followed a practice which has been considered sound in accounting circles, of writing off the good will. Some have done it in one operation, others have

done it in piecemeal fashion, but nevertheless a good will figure, which was actually bought and paid for in cash or [fol. 6941] property, let us say for $10,000,000, has been eliminated from the books by writing it down to one dollar. Those companies, to establish their invested capital base under the Act, have had to rehabilitate their accounts in order to re-establish that invested capital figure.

Q. Which account are you speaking of now?

A. The second Revenue Act of 1940 which was the first, if I recall correctly, to provide for the excess profits part of the tax law.

Q. Well, the Act that I am speaking of is the one that Mr. Morgenthau refers to in his statement dated September 24th in the New York Times, as it appears in your Exhibit 152. Can you define what he means by that term?

A. Well, he means there, as I understand it, the capital that is actually invested in the business as represented by securities but allowing for only 50 percent of any debt outstanding.

Q. What do you mean by the latter part of your statement?

A. I mean when you compute your tax credit at the present time, you are only allowed 50 percent of your bonded and funded debt and other debt to be taken into consideration. I believe I am correct in stating that. I haven't read it for a while, but I think I am right in that. [fol. 6942] Q. Well, have you ever seen Mr. Morgenthau's definition of invested capital as he uses it for purposes of this statement made by him?

A. Not his statement, but if you are including his statement to be that which comes out in the regulations, the regulations at the present time define invested capital and in that calculation they allow only 50 percent of the debt for purposes of computing this credit under the invested capital credit.

Q. Do you know whether Mr. Morgenthau's definition of invested capital is the same as your definition of invested capital as you have used that term in your Exhibit No. 65?

A. I believe generally that with the qualifications of 50 percent of debt there won't be much difference.

Q. You are not altogether certain about that, because you don't know. You would want to check it?

A. I would want to check it, but I think it would closely approximate the figure.

Q. Not having read or seen Mr. Morgenthau's definition of invested capital as he uses it in this statement which appears in Exhibit 152, you are not prepared to state whether it is the same as your term "invested capital" as you have used it in Exhibit 65?

A. I would like to refresh my mind, but I say that [fol. 6943] my recollection is sufficiently good to say that there is not any substantial variance, any substantial variation in the two.

Q. You have not adjusted the earnings-price ratios which you used in order to take into account and to give effect to these numerous risks which we discussed a few minutes ago that the investor has taken into account; is that correct?

A. No, that isn't correct, Mr. Littman. I have very definitely taken them into consideration because, if it is true, which I believe it is, that investors have been cognizant of these various items and appraising them to the best of their ability, I have already said that that is registered in the price of the security, therefore, when I used the price of the security as one factor in calculating an earnings-price ratio, automatically I am giving e[illegible] to those items.

Q. Well, of course, the price of the security has already discounted all of these dire consequences, isn't that correct?

A. No, I don't think I said that at all. I said that the investor was discounting and will continue to do so, so long as he has not yet established in his own mind the exact, ultimate act, whatever it may be.

Q. Let's be specific about it. Turn to Chart No. 22 [fol. 6944] of Exhibit 65. There you show the earnings-price ratio of the Panhandle Eastern Pipe Line Company as 11.53 percent for the last 1941 period; is that correct?

A. That is correct.

Q. And it is that 11.53 percent earnings-price ratio, based on 1941 market prices, for Panhandle Eastern Pipe Line Company that has taken into account all of the numerous elements that we have discussed earlier today?

A. That is correct, but when I said that I didn't say nor mean to imply that that meant the investor had

jumped to the ultimate result and appraised it all. I said that as these conditions were occurring he was re-appraising the situation. I didn't say that he had jumped to the final result, otherwise the price might have dropped from whatever it was, 36.50 to 5. Investors are perfectly willing to bide time where the eventuality is not a dead certainty, so that there will be a gradual evolutionary process. It isn't done in a single day or week or month.

Q. Mr. Coffman, I thought we had been all through this before and understood each other perfectly. I am afraid we will have to go back over it again. Tell me whether or not this 11.53 percent earnings-price ratio of Panhandle Eastern Pipe Line Company common stock shown in Chart No. 22 reflects the investors' fear that there will be [fol. 6945] an increased cost in operations and maintenance in the succeeding year. Does it or doesn't it?

A. It does.

Q. Now, shall I go through all these elements again or are your prepared to say that this 11.53 percent reflects all these various elements?

A. No, you don't have to do that. I still say that my statement is 100 percent accurate, my answer to you is 100 percent accurate. You did not nor did the investor conclude at the time he was making these appraisals, that is, day in and day out, as he transacted shares in the market, that the final result, for instance, of the rate case, the final result of costly litigation, the final result of increased taxation and so forth, he did not go through that and crystallize the ultimate eventuality, because he is in no better position to do that than anyone else; it is not possible, so what he does is make such allowance as he can at the time, so the 11.53 includes those items but not the final eventuality on all of them, because he doesn't know, he is just trying to approach it gradually as history is made day in and day out.

Q. Don't you know, as an expert in this field, Mr. Coffman, that the investor actually exaggerates elements such as those which you discussed this morning, the imminence of rate cuts, the imminence of higher taxes and so forth? [fol. 6946] Isn't that correct?

A. Why, I don't believe he exaggerates those things; Mr. Littman, no; in some isolated case you might find that he had over shot the mark, that he thought that it was

going to be worse than it really was, but when you talk about the market as a whole, I think it is about as good a barometer for a solid estimate as any you can find.

Q. Then, it is your testimony that the investor does not exaggerate the fears and risks?

A. My testimony is exactly this: I don't know as I could phrase it any better, that taking investors as a whole and on the average, I do not believe they tend to exaggerate. I think they hit the market pretty closely. In isolated or individual cases they may over-shoot the mark, but taking the market as a whole, which I was attempting to do in getting the investors' appraisal of risks, I think it is a very close approximation, weighing the factors, as they come up, to be considered.

Q. Well, if the investor makes a close appraisal, how much has he discounted in this 11.53 percent for the increase in taxes?

A. Well, there, again, I have to tell you that I can't give you a specific amount on each item; I don't know, but any individual that is working on any problem will take a group of figures and he will talk in terms of average ex- [fol. 6947] pectancy of so much and the over-all figure may be pretty close to the final result.

Q. But you know that this 11.53 percent reflects the investor's knowledge that taxes are going to increase next year?

A. That is right, so far as he has discounted that particular item to the date that this ratio was calculated at 11.53 percent.

Q. And that 11.53 percent includes the discount by the investor for all the other fears and risks which we have discussed this morning?

A. In so far as he has discounted them to that date.

Q. Your answer is: yes, in so far as he has discounted it to that date?

A. That is correct.

Q. Do you agree with this statement, which I read from page 473 of the "Outlook for the Securities Market" dated October 13, 1931, published by Standard and Poor's Corporation: "Conjecture along these lines is presumably among the reasons for the further easing of stock prices last week. It is the habit of speculative markets to prepare for the worst, but it is no easy matter to tell in ad-

vance at what level the unfavorable contingencies will be discounted or over-discounted. The market, clearly, is allowing for many unfavorable events which may not come [fol. 6948] to pass." Do you agree with that statement?

A. I think that is a correct statement, yes.

Q. Now, when you came to make an estimate of the cost of common stock money to Panhandle Eastern Pipe Line Company for your projected period of June 30, 1941, you raised the figure from 11.53 percent, as shown on your chart No. 22, to 12 percent; isn't that right?

A. That is correct.

Q. Why did you go even higher than the indicated earnings-price ratios which took into account all of these various hazards and risks that we have discussed earlier today?

A. I did it because in studying the various factors, which are shown graphically on Chart 22 of Exhibit 65, and supporting data, it seemed to me that it was clearly indicated that a figure of 12 percent, which I said was a judgment figure, closely approximated for this study the risk of this enterprise as it would be appraised by investors when it came to additional financing and that was based on the fact that the average of the pipe line companies was practically or was actually 12.99 percent, to use the figures shown in the chart mentioned. The comparison with Northern Natural, which was a later development, and the actual common stock figure, earnings-price ratio was 11.53 at that time.

[fol. 6949] Q. Well, the earnings-price ratio for Northern Natural was 10.38 percent, as shown by your Chart No. 21, and you used 12 percent for Panhandle Eastern? Why?

A. I explained that, I think, to you yesterday, Mr. Littman. I said that I had taken into consideration the difference in the capital structure of this company against Northern Natural Gas Company which would definitely be taken into consideration by the investors along with the other factors which are considered already in the exhibit.

Q. Well, is it your testimony that the investors today would require 12 percent earnings, would expect a 12 percent earnings-price ratio?

A. Yes, that is my testimony and I believe if I took Northern Natural prices as of today and made a calcula-

tion I would find that that percentage had gone up quite a bit from 10.38 which you mentioned, which is a further indication of the trend, so the 12 percent doesn't seem to me to be out of line at all.

Q. You are not suggesting that you want to raise the 12 percent?

A. No. That was a judgment figure that I used at that time based on this study. As I have said repeatedly in this testimony, until conditions change so radically, as related directly to the Panhandle Eastern Company, I will stay with my figure. When conditions so change, I would [fol. 6950] want then to take another look.

Q. Now, in your in opinion, then, you say that the investors expect to earn 12 percent on their common stock investment in Panhandle Eastern Pipe Line Company?

A. Well, to turn it around, what I am saying is that so long as the conditions which we have enumerated continue to be present, that investors in the common stock of Panhandle Eastern Company will likely require a 12 percent earnings-price ratio if they are to be approached to purchase additional common stock.

Q. That statement holds good today?

A. It holds good at the time of this study. I haven't brought this down to the date of January 28. I think, generally, it would be true today and I still make the statement, and I don't know how to change it, that until I am sure that conditions have changed radically, so that the factors are altered radically, this figure would hold.

Q. You say that you cannot advise the Commission whether it may rely upon this 12 percent figure shown in Chart No. 22 today?

A. No. I am saying that so far as I am concerned, that figure closely approximates conditions today, and I am sticking with it.

Q. And it has approximated conditions and would hold [fol. 6951] good each day back to June 30, 1941?

A. Well, I wouldn't say each day, because I have said that we are talking about on the average.

Q. Well, on the average, would it?

A. On the average, yes, I think so.

Q. Well, are you saying that the Commission can rely on this 12 percent figure one day and not on the next day?

A. No. I just got through saying that you can rely on it on the average in a period such as we have been in and are in right today.

Q. How about tomorrow?

A. Tomorrow, too, if you say "on the average." You have to have more than one or you can't get an average.

Q. Did you testify in the Young suit as to what return investors in Panhandle Eastern Pipe Line Company's common stock might reasonably expect?

A. I testified as to what I thought the reasonable expectancy of earnings might be on the common stock, as I recall.

Q. Do you remember what you said on the subject?

A. I don't, no.

Q. Do you remember the percentage that you used?

A. No, I don't believe I remember that.

I recall to your mind again that reference to the date of the Young suit is taking us back before Munich and the [fol. 6952] war, so far as we were concerned, and a hundred other items, so that certainly whatever I said there would apply to the times then and would not necessarily apply now.

Q. Well, you testified in the Young suit in the latter part of 1939, did you not?

A. That is correct.

Q. And you there stated that your testimony with respect to your projected period would hold good for an indefinite period in the future, did you not?

A. No, no, I didn't say "indefinite period." I said "a reasonable period," I believe.

Q. What was a "reasonable period", speaking as of the end of 1939?

A. Ordinarily, I would define a reasonable period where we weren't having tremendously abnormal conditions as something around three years but after all, it is not the length of period that is to be taken into consideration, it is various factors that you have to consider, for example, I can talk to you today about this situation and if tomorrow I would discover that the British Isles had been blown out of the sea and the Allied Powers were definitely to be licked and the best thing we could do would be to make any kind of peace that could be done,

I think probably I would want to have the opportunity to change my thought.

[fol. 6953] Q. Mr. Coffman, did you testify as follows in the David Young III suit:

"I concluded from this data that 7½ percent rate was a reasonable rate to capitalize the dividends which had been projected on the common stock of the Panhandle Eastern Pipe Line Company"?

A. If it is so stated in the record, I said it, yes.

Q. Now, will you state how you reconcile any such figure with the 12 percent that you are using for purposes of this proceeding?

A. Yes, I just got through doing that. January 28, 1942, is not a point to be compared with July of 1939, or whatever date it was of that case. If all other conditions had remained the same, I probably would be talking in terms of 7½ percent, but the fact is that all other conditions have not remained the same, investors so state, and I am registering that fact in this study.

Mr. Wheat: Mr. Littman, I am sorry. I was doing something else. Was that a 7½ percent dividend rate?

The Witness: I will explain it. It is a 7½ percent dividend rate. It is a yield rate.

Mr. Wheat: Thank you.

By Mr. Littman:

Q. What portion of earnings did you testify in the David Young suit should be distributed by way of dividends?

[fol. 6954] A. I don't recall, but if you have that photostat copy, I can tell.

Q. Was it approximately 80 percent?

A. That would sound about right to me, but if you have those charts, I think I can tell you.

Q. Very well. I will hand you the charts.

A. 80 percent, I think, sounds about right.

Mr. Wheat: Will you read the question, please?

(Whereupon the question on line 24, page 6953, was read by the reporter.)

The Witness: It was .80 percent.

By Mr. Littman:

Q. Yes. Now, Mr. Coffman, you have said that conditions have changed since you testified in 1939 in the David Young suit which warrant raising the figure from seven and a half percent up to 12; is that right?

A. That is correct.

Q. That is right? A. That is correct.

Q. Will you look at your chart No. 19 of Exhibit 65, and will you read into the record from that chart the average earnings-price ratios of natural gas pipe lines' common stock for the year ended 1938, the average shown?

A. El Paso Natural Gas Company—

Q. (Interposing) No. I mean the average for all [fol. 6955] of them. Isn't it 13.45 percent?

A. 13.45 percent, yes.

Q. And what is the average in 1939? A. 13.28 percent.

Q. And what is the average as shown in Chart No. 22 as of the last period in 1941 for the natural gas pipe line companies? A. 12.99 percent.

Q. Lower as of 1941 than as of 1939; is that correct?

A. Yes, the 12.99 is somewhat lower than those other figures.

Q. Well, certainly your average earnings-price ratios show that if there has been a change since 1939 with respect to the common stocks of natural gas pipe line companies, the change has been down, not up; isn't that right?

A. Well, for the average that is true and I took that into consideration. I used the 12.99 percent.

Q. You certainly did take it into consideration. You raised Panhandle up from seven and a half percent to 12 percent.

A. No, I deny that.

Q. And the average shows that all the rest of them on the average went down; isn't that right?

A. No, that absolutely is wrong, because you are con- [fol. 6956] fusing two issues. We are talking in this present hearing about earnings-price ratios and have been throughout and now you are trying to make a comparison with the David Young suit of a seven and a half percent which is a yield, so that those two just

can't be compared and it is misleading to undertake to do it.

Q. Well, give me the yield for Panhandle Eastern common stock, in your opinion, comparable to the seven and a half percent that you testified to in 1939.

A. Well, I would have to make some calculations to get that. I can do it at noon or if you want to take some time out, I can do it now.

Q. Isn't that a perfectly simple calculation? 80 percent of your 12 percent would give it to you, inasmuch as you have stated that 80 percent is the proper amount of earnings to be distributed to common stockholders as dividends?

A. No, I don't think it is that simple, Mr. Littman, because what I would have to do to make the calculation is to go back and get the dollar amount and see what is taken out, first, of earnings. In other words, I would have to take the earnings available for common stock, eliminate the senior capital and then find out what that would be in terms of per share. It isn't quite as easy as you suggest.

[fol. 6957] Q. Are you stating that less than 12 percent should be made available to the common stockholders by way of dividends?

A. Well, my goodness, it would have to be.

Q. Well, how much?

A. I haven't heard of any company ever distributing 100 percent of its earnings unless it was about to liquidate. You have to have something for working capital and for a margin of safety if you want to continue to operate.

Q. How much money would be available for dividends on common stock of Panhandle Eastern according to your study in Exhibit 65? It must be 12 percent, must it not?

A. Common stock, earnings available, as shown in Chart No. 37 of Exhibit 65, including the surplus is $3,540,995.

Q. And that amounts to 12 percent of the outstanding common stock and surplus? Isn't that right?

A. That is correct.

Q. Now, how much of that amount should, under your theory and under your study, be available to the common stockholders by way of dividends?

A. You are still confusing two things, Mr. Littman. The common stock, so stated, also includes surplus, so that if you take 12 percent, what you are going to say is that you will distribute not only a percent of this year's [fol. 6958] earnings, but you will distribute all the past accumulated earnings. I say that the management couldn't possibly think of it, so you have got to get that distinction before you go on. That is the reason, if you want the figure, why I would like to calculate it accurately instead of jumping at some of these simple things which will give you a wrong answer.

Q. Are you saying that the earnings required by the common stock and surplus of Panhandle Eastern Pipe Line Company should be something less than $3,510,995, shown in your table for Chart No. 26?

Mr. Wheat: Will you read that, please?

(The pending question, as above recorded, was read by the reporter.)

The Witness: No, I am not saying that it should be less, I am saying that it is the dollar amount represented for the common stock and surplus. All I wish to do is to distinguish between the two items and make a calculation.

Q. Now, you are at this time unable to state what percentage of return the common stockholders of Panhandle Eastern Pipe Line Company are going to earn on their investment as of today under your study?

A. Why, I am not aware that I said any such thing as that.

Q. Well, state the figure, then.

A. The figure for the total amount is just what I have [fol. 6959] read from Chart 37 in Exhibit 65, $3,510,995, but those are dollar earnings, they are not dollars of dividends.

Q. All right. What dividend rate are you assuming for purposes of your study for the stockholders of Panhandle Eastern?

A. In this particular case, I made no assumption of any dividend whatsoever. I didn't make any.

Q. You didn't make any? A. No, sir.

Q. You are unable to state at this time what the common stockholders of Panhandle Eastern are going to receive by way of dividends, according to your study?

A. Yes, that is correct.

Q. You are unable to state that?

A. That is correct.

Q. ~~Now, does your testimony~~ in the David Young suit concerning the 80 percent distribution of earnings available for common stock still hold good?

A. I don't know, it might; I haven't made that a part of this study. It could be 80 percent or it could be less; obviously I don't think it could be any more and still have this company operate on a sound managerial basis.

Q. Will you please make the calculation? Can you [fol. 6960] make that calculation over the noon recess?

A. Yes, surely.

Q. You will report back after the noon recess as to the percentage of earnings to be distributed to the common stockholders? A. Yes, I will.

Q. And that will give you a figure which you will state into the record which is comparable to the seven and a half percent dividend figure which you testified to in the David Young case. I mean the same type of figure?

A. It wouldn't be exactly comparable.

Q. Well, will it be close, close enough for all practical uses and purposes?

A. Well, I will say that it will be a figure.

Q. Well, if that is all it is going to be, it isn't going to be worth much by way of enlightening the record.

A. The only point I make, Mr. Littman, unless I use the identical procedure here throughout the study that was used in the David Young case, is that I don't see how you can say the figures are comparable as such. It is true each figure represents a percent of earnings paid in dividends and gives you a yield rate, but there is still a difference.

Q. Depending on what case you testify in?

A. No, it doesn't make any difference to me about that.

[fol. 6961] Q. Well, if we want it to be strictly comparable, can't we use the same 80 percent here that you used in the David Young case?

A. No, I don't think so, because I just don't think at the moment that you are talking about the David Young suit and leaving the impression as to what it was. The

only purpose that I ever had, the only assignment I ever had in the David Young case was to discuss the Columbia Oil and Gasoline Corporation, but I found in making that study that it had a large equity in a subsidiary called Panhandle Eastern Pipe Line Company. Using the method of projection there as a basis of establishing fair value, it was necessary for me, naturally, to find out about what the top company, naturally, Columbia Oil and Gasoline Corporation, could expect to receive from that subsidiary in the way of earnings on the stock it held in order to find out what that top holding company would have by way of earnings for its security holders. That is what I testified in the David Young suit, if I recollect correctly.

Q. Now, would you use a different method here to ascertain what dividends Panhandle Eastern's present stockholders have a right to [reasonable] expect, or do you use a different method here?

A. Well, we are just talking about different things, Mr. Littman. In the case of the David Young suit, I was [fol. 6962] asked to determine a fair value, that isn't a part of this proceeding, if I understand it correctly, at all.

What I did here was to try to ascertain the number of dollars that would be needed to keep this firm going. I wasn't trying to say that the value of the Panhandle Eastern common stock is thus and so.

Q. Well, but, Mr. Coffman, you have clearly stated that in the process of arriving at the ultimate result that you were seeking in the Young suit it became necessary for you to determine the amount of dividends which the common stockholders had a right to expect or could reasonably expect; is that right?

A. That is right.

Q. And that was based upon your projection of earnings of 8.4?

A. I don't know about the figure, but if the figure is what you state in the record, I accept it.

Q. Well, we stated it yesterday.

A. Yes.

Q. I am asking you to do the same thing here, to determine for us, according to your study shown in Exhibit 65, the dividend rate which the stockholders of common

stock of Panhandle Eastern Company might reasonably expect out of this 12 percent earnings figure which you have used. Is that right? Isn't that what you under-[fol. 6963] stand me to ask you to do?

A. That is correct.

Q. Now, why should the method of reaching the answer to that problem here be any different from the method that you used in the David Young suit?

A. Well, merely because that, since the David Young suit, I have made more elaborate studies and I have come to this report, the three exhibits, which is as complete as I have produced and I believe that the calculations that I have made here and the data that I have used is more complete, for one thing, than I had available to me at the time I testified in the David Young suit. I have come to rely more on the matter of what the investors require in the market to find out whether they will be willing to invest further capital in the business or not.

Q. Well, now, you had an over-all earning figure in the David Young case, did you not? A. I did.

Q. And you have an over-all earnings figure here?

A. Yes, that is correct.

Q. And your over-all earnings figure here you consider to be more accurate than the one in the David Young suit?

A. Under the conditions of this study, yes.

Q. That is just what you said in effect a moment [fol. 6964] ago?

A. That is right.

Q. Now, what does that have to do with the accuracy of a method for determining the portion of those earnings attributable to dividends to the common stockholders?

A. Why, it has everything to do with it, Mr. Littman. As I got through saying, in this case I didn't talk about dividends at all. I made no study as to what is the proper rate, what I would suggest as fair, whereas in the David Young suit I did.

Now, I can make a calculation for you again, but it wouldn't be based on a study where I have devoted time to seeing what would be, under the circumstances, a reasonable amount. I will look at it to the best of my ability, take a percentage figure, find out what those dividends would be on the basis of those earnings, and give you a yield figure and that is what it will be, just based on

what I have said and nothing more. That is the difference between this method and that. In the David Young suit I set out to do one thing and did it. In this case I didn't have to consider dividends, so I didn't consider them.

Q. I am asking you here to consider dividends in the same manner that you considered dividends in the David Young suit, that is all.

[fol. 6965] A. I know, but I spent some time doing that on the David Young suit. I didn't just go over on my lunch hour and compute it and come back with a report. I just want to make that clear.

Q. Mr. Coffman, if the figure that you speak of computing over the noon recess is as meaningless as that, as you indicate, I don't think I want you to compute it for me. If it isn't going to mean anything, we don't want to have it.

Trial Examiner: Do you understand, Mr. Coffman, that you are to prepare something?

The Witness: I understand that I am to forget it.

Trial Examiner: That the request is waived?

Mr. Littman: Yes, sir, in view of Mr. Coffman's statement that the figure would not be a proper one for us in this proceeding.

The Witness: I didn't say it wasn't proper. I will stick by the answer I gave, not by the answer you imply I said.

By Mr. Littman:

Q. Well, can you give us a figure that will be a reasonably accurate figure showing the amount of dividends that Panhandle Eastern's common stockholders might reasonably expect to derive from your 12 percent over-all earnings on common stock?

[fol. 6966] A. Yes, I can, but I just don't want to commit myself to do it on a noon hour and say, "Here it is. It is perfect." If you want to give me a little more time, I will be delighted, but on a noon hour, no, I am saying it is meaningless.

Q. Don't you recall that I asked you a few minutes ago whether you could do it on a noon hour and you said certainly you could?

Now, if it is going to take longer, you can have more time, but I want you to state how long it will take.

A. I would like to have the record straight myself. I think I said to you that I could get a figure but that it would not be comparable. How long would it take? Well, I could work it over a noon hour, but it is just that kind of a figure, so I wasn't at variance with any of the statements, was I? If you would like to give me a little more time for the figure, I personally would like to have until around Monday.

Q. Well, we have too many strings attached to this figure and, therefore, we will waive the request.

Now, will you please turn to your Chart No. 19, Exhibit 65?

Do you know what the depreciation policies of the five natural gas pipe line companies which are listed in this Chart have been?

[fol. 6967] A. No, I don't. I have said already that I took the figures that were used in these calculations from annual reports as a dollar figure and that is the amount that goes to the stockholders or the investors and that is the only amount that they have to go on, to form an opinion.

Q. In other words, you do not know what the depreciation policies are of the five natural gas companies shown on Chart No. 19, to-wit, El Paso Natural Gas Company, Interstate Natural Gas Company, Memphis Natural Gas Company, Southern Natural Gas Company, and Panhandle Eastern Pipe Line Company?

A. No, but in using the figure in the annual report I was aware of the fact that all of those utility companies are subject to commissions which have certain uniform accounting procedures and they have to file reports. I thought it was a fair assumption of what they showed in their annual report and was not, very likely, very far off from being a fairly proper figure. I made that assumption.

Q. That is quite an assumption.

A. Well, I came back to my statement that that is the figure that is reported to the prospective investor. That is all he has to go on. He is putting his capital up or has

his capital already in the business and that is the figure [fol. 6968] he gets.

Those statements were certified by accountants so they couldnt be too much out of line with sound accounting practice, I would say.

Q. You didn't assume that Panhandle Eastern Pipe Line Company was setting aside a sufficient amount for depreciation, depletion, and amortization, did you?

A. In my calculation, I took 1/25 as I have explained, and as is fully recorded in the record.

Q. Yes, and it gave you several hundred thousand dollars in excess of what Panhandle Eastern was actually charging on its books, didn't it?

A. I forget the exact amount, but that is a close approximation.

Q. And the Panhandle Eastern Pipe Line Company's depreciation amounts have been certified in their statement; is that right?

A. That is right, but you are neglecting to consider other parts, which are equally right, of this study, wherein I said I was undertaking here to ascertain the number of dollars needed to render a service and maintain the credit. In this particular case, looking 25 years in advance, based upon Ralph E. Davis's report, I felt that was as long as you could ask investors to try to discount what was going to happen. Therefore, I took 1/25. [fol. 6969] Q. And that gave you approximately $225,000 per year more for depreciation, depletion, and amortization than Panhandle Eastern Pipe Line Company had charged for those purposes on its books in the past year; isn't that right? Approximately?

A. Approximately, that is correct, yes.

* * * * * * * *

[fol. 6970] By Mr. Littman:

Q. Mr. Coffman, yesterday I requested you to make a calculation with respect to the net income that would be available to the company after taxes computed on the basis of the 1941 Federal income and excess profits tax, assuming a reduction in gross revenues of $1,000,000.

Do you have the calculation with you?

A. Yes, I do.

Q. What do you show?

A. In answering this, Mr. Littman, may I tell the figures I used and then the answer so that we will be sure that I used the right base from which to deduct the $1,000,000?

Q. Yes.

A. I took the gross revenues for 1940, the full year, which was $13,535,453 and subtracted therefrom the $1,000,000 figure which you gave me so that my adjusted gross was $12,535,453.

[fol. 6971] Then, allowing all other deductions except the taxes to remain the same and calculating the tax figure on the same basis in accordance with the Act as in the exhibit, the amount for Federal income and excess profits taxes would be $2,644,475.

Mr. Littman: Will you read that figure?

(Whereupon, the figure indicated was read by the reporter.)

The Witness: And that figure is based upon the 1941 tax rates.

By Mr. Littman:

Q. I do not know as I understand this figure of $2,644,475. What is that?

A. That is the figure comparable, on Chart No. 30, Exhibit 65, to the figure in the amount of $3,363,000 in my projected column.

Q. What was that figure?

A. $3,363,000 even, and the new figure was $2,644,475, making the adjustments you requested.

Q. In other words, this $2,644,475 is to be deducted from the $3,363,000 shown in Chart No. 30 and you get $718,525?

A. Well, I do not know exactly what you are doing there because the $3,363,000 was computed, as you know, not on the basis of the adjusted revenue for 1940, so that [fol. 6972] I merely said the figure was comparable. I did not say deduct it.

Q. Let me see if I understand you. What you are saying is that, applying the 1941 tax rate, the Federal income taxes and excess profits taxes would be $718,525 less than the $3,363,000 shown on Chart No. 30 if the gross revenues were $1,000,000 lower than that assumed for Chart No. 30?

A. No, Mr. Littman, what I am saying is that computing the Federal income and excess profits taxes at the 1941 rates but based upon the 1940 gross revenue minus $1,000,000 for tax adjustments, gives you $2,644,475.

Q. Of taxes?

A. Of taxes, of Federal and excess profits taxes, yes.

Q. In other words, if the gross revenues had been reduced by $1,000,000, the taxes would have been $2,644,475 instead of $3,363,000?

A. Using the full year, 1940, gross revenue as a base minus the $1,000,000.

Q. And you have read the gross revenue figure into the record, have you not? A. Yes, I did.

Q. Does your calculation show that for each dollar that gross revenue is reduced, net operating revenue will be reduced by less than 30 cents?

[fol. 6973] Mr. Wheat: You mean assuming that Uncle Sam loses a little over 70 cents in each instance?

Mr. Littman: Under the assumption that this witness has made of gross revenue.

Mr. Wheat: That was my assumption, too.

The Witness: Would you read that question now, please?

(Whereupon, the pending question was read by the reporter.)

By Mr. Littman:

Q. Maybe we can get at it this way, Mr. Coffman.

A. I do not believe we are comparing the same figures.

Q. Let me take it up step by step and we will try to make certain that we understand each other.

Now, you have testified that, under the assumption that you made of the reduction in gross revenue of $1,000,000 from 1940 revenue, that if the 1941 Federal income tax and excess profits tax were applied, the reduction of $1,000,000 in gross revenue would produce a reduction in those taxes of $718,525, isn't that correct?

A. No, that is where I say you are making an inaccurate comparison, Mr. Littman.

Q. I am trying to understand your calculation.

A. By your own assumption, in my opinion, there is only one way that it can be done. The comparisons would be this:

[fol. 6974] First, we must stick with the adjusted gross figure which is the full year 1940 figure gross, minus $1,000,000. That adjusted figure was then $12,535,453.

That is merely a million dollars difference in what the actual report shows.

Now, to get the comparison straight, we would have to make a comparison of the reduction in gross, as just stated, calculate the income-tax rate thereon at the 1940 rate to get the new tax figure.

Then we would take the adjusted gross, apply the 1941 rate to get the tax figure. The difference between those tax figures would be the change in the tax on the same basis attributed solely to an increase in rates so that you can not make the comparison and get anything out of it, so far as I can see, by comparing my figure of $3,363,000 against your hypothetical situation.

Q. Well, apparently you have not given me the figure that I want.

A. Yes, I believe I have. You asked me, if I recall correctly, to take the 1940 full year gross, and assume a rate reduction equivalent to $1,000,000, if I recall correctly.

Then you said recalculate that situation, so far as taxes are concerned, using the 1941 tax base and that is exactly what I have done to get the $2,644,475, but that figure [fol. 6975] cannot be subtracted from the $3,363,000, as such, I think, to make comparison if you want to ask the question you are asking.

Q. All I wanted was this and possibly we should not have injected the 1940 revenue into this at all.

A. That is right.

Q. All I wanted was that you assume a reduction in gross revenue in the year 1941 of $1,000,000, which $1,000,000 would fall into the highest tax bracket, and merely state how much of that $1,000,000 would be paid in taxes, both Federal income and Federal excess profits taxes, and how much then would be left to the company by way of net operating revenue after taxes.

A. All right.

Q. That is a rather simple question.

A. That comparison would be all right but the figure I have given you, you cannot use for that purpose. I cannot do that here in a couple of minutes but I can have that done while I am going on or I can do it and submit it to you later.

Q. That is perhaps stated more simply. If you could have that done for me, I would appreciate it.

A. All right.

Q. Now, at the noon recess, we were discussing your Chart No. 19 and Chart No. 20 of Exhibit No. 65 and I be- [fol. 6976] lieve you stated that you do not know what the depreciation policies are of the five natural-gas pipe-line companies shown in those charts, to wit, El Paso Natural Gas Company, Interstate Natural Gas Company, Memphis Natural Gas Company, Southern National Gas Company and Panhandle Eastern Pipe Line Company, is that right?

A. As I said, I took the published reports, looked at the dollar amount that was segregated for the item to which you refer and that is the figure I used.

I have no detailed knowledge about specific depreciation policies or procedures.

Q. Of any of those companies?

A. Of any of those companies.

Q. Then you do not know, of course, whether these companies have, in fact, made adequate or inadequate provisions for depreciation, depletion and amortization?

A. I have not made such study. As I say, I assumed that the figures shown in their annual reports, most of which, if not all of which, were certified, must have been within the realm of reason from the accounting point of view.

Q. So that your answer to my question is that you do not know?

A. No, I made the assumption I have just stated.

Q. Now, if the provisions for depreciation, depletion and amortization by these companies have been inade- [fol. 6977] quate, what effect would that have upon the companies' earnings? Would they be overstated or understated?

A. Overstated.

Q. And what effect, in turn, would that have upon the earnings-price ratios of those companies? Does it follow that under the assumption which I made the earnings-price ratios shown in Charts Nos. 19 and 20 of Exhibit No. 65 would be correspondingly overstated if those companies had been making inadequate provisions for depreciation, depletion and amortization?

A. That would be true at the time of the calculation.

Q. Now, the earnings-price ratios, as shown in Charts Nos. 19 and 20 and also those shown in Chart No. 22, for "Average of pipe-line companies", Panhandle Eastern Pipe Line Company and Northern Natural Gas Company are determined by using the market price of the common stock as related to earnings?

A. The average market prices related to earnings per share, yes.

Q. Of course, we are excluding from that answer the 12 percent figure shown at the extreme right-hand side of the column of Chart No. 22 of Exhibit 65 which is your final judgment figure?

A. That is a judgment figure, yes, sir.

Q. Now, assuming that the common stock of a natural [fol. 6978] gas pipe line utility is selling on the market at twice its book value, isn't it a fact that such utility would have to earn 24 percent of the book value of its common stock in order to show an earnings-price ratio of 12 percent on the market price of that stock?

The Witness: Would you read that question, please?

(Whereupon, the pending question was read by the reporter.)

By Mr. Littman:

Q. That is purely a mathematical result, is it not?

A. Well, I would like to make the observation that it seems to me there that we are again confusing two things. It is one thing to say what the market price of a share is. It is another thing to talk about book value.

Throughout this proceeding here, I have talked in terms of market value.

Q. I do not think there is anything at all confusing about the question. I am asking you to assume that the

common stock of a given natural-gas pipe-line utility is selling on the market at twice its book value and I am asking you whether, under that assumption, it is a fact that such utility would have to earn 24 percent of the book value of such common stock in order to earn 12 percent on the market price of that stock?

A. Yes, I think that is correct.

Q. Now, would you recommend in those circumstances [fol. 6979] that a 24 percent return be allowed on the book value of the common stock of such a pipe-line company where that stock is selling at twice the book value in the market?

A. Well, before I answer that, I have got to explain I do not think book value, as such, means anything, so why should I say 24 percent, 12, or 36?

Q. You do not think book value of the common stock means anything?

A. Not in comparison to investor's appraisal, no. The investor is appraising this concern as an operating concern and he is looking at the earning power.

Take railroad companies, for example, that have a tremendous book value. The earnings are nothing and the investors in the market are saying they are worth nothing.

Q. Under the assumptions that I have given you of a company whose common ~~stock is~~ selling on the market at twice its book value, would you recommend that a 24 percent return be allowed on that book value where that stock was selling at twice the book value in the market?

I take it your answer is "yes", because you say you do not think the book value—

A. (Interposing) If your assumption is true, I will say "yes", because, as I have stated, book value, as such, without careful analysis, has no meaning.

Q. Well, did you make any allowances of the book [fol. 6980] value of these various natural-gas pipe-line companies which you have compared with Panhandle Eastern Pipe Line Company in your Charts Nos. 19, 20 and 22 of Exhibit 65?

A. The only one that I compared is the one shown on Chart No. 24, Exhibit 65, which is a comparison of Pan-

handle Eastern and there it is shown that the book value and the market value were very close together.

The rest of them, I made no comparison. I used market prices, as I have stated.

Q. Is it your testimony that you do not attach any significance to the book value or book cost of the common stock of any natural-gas pipe-line company?

A. I did not say that. I said that in the analysis which is made here, I had no occasion to use book value and that book value, in and of itself, without an analysis, does not represent any particular thing so far as investors are concerned, because, as we all know, there are many stocks selling above, considerably above, their book value and there are many other companies' stock selling considerably below their book value.

It just so happens in this particular study that the book value and the market value, as of June 30, 1941, for Panhandle Eastern Pipe Line Company, were about the same.

Q. Well, what significance do you attach to that?

A. I did not attach any except to show the comparison [fol. 6981] that existed. I did not use it in the study. I had no occasion to use it.

Q. What, if anything, does it indicate to you?

A. I put it in for the use of the Commission, merely to show, if there was a question about book value of Panhandle Eastern, the figure was a certain amount and if you wanted to compare it on the market value, it was another amount and the two totals are $61,423,853 on a book-value basis for total invested capital and $64,219,240 on a market-value basis. The two figures are close together.

Q. That is just a circumstance or just a happenstance?

A. There are many companies where that would not hold true at all, yes, many companies.

Q. And it would not make any difference one way or another, would it?

A. For this particular study it would not, no.

Q. So that for your purposes, it is the ratio of earnings to the market value of common stock that is important and not the ratio of earnings to book cost of common stock that is important?

A. Well you have there, again, got to define some language.

Q. For the purpose of your study, I said a moment ago, you did not attach any importance in this study to book cost?

[fol. 6982] A. I do not want to be fussing, Mr. Littman, but when you talk about "book cost" in one place and "book value" in another place, let's get the language straight.

There are many companies where books do not show value in book cost because there have been appraisals and reappraisals made which do not show up without analysis so it does not mean anything.

If you eliminate the book cost and talk about book value, such as the book value is, I say that it varies as between companies and in this case, I did not refer to it for purposes of my study.

Q. Let's then talk about book value. You gave book value no consideration because it does not amount to anything for the purposes of your study in this case?

A. That is correct, because I was taking the investor's risk appraisal which depends upon market values and not upon book values.

Q. So that if the earnings-price ratio of a common stock of a particular natural-gas pipe-line company of 12 percent, in reality represented a 24 percent return on the book value of that stock you would, nevertheless, recommend, all other things being equal, that the 24 percent return on the book value be allowed?

A. On the assumption, as you have stated and as I understand it, my answer is "yes".

[fol. 6983] Q. Now, if a 12 percent return on market value of common stock was reasonable, as you suggest, then rates of return on original cost for different companies would vary according to whether the market price of the stock was more or less than the book value under your theory, isn't that correct?

A. I do not think so, if you follow the statements I believe I have made.

In other words, if it is true that a market price is the best indicator you can get as to what investors believe

is the value of this company, which includes original cost plus earning capacity, then that is the value the investors say is there and the book value may be $10 and the market value $20 or any variable.

The market price weighs not only the original cost but the earning capacity of the firm. I think that we have discussed that in perhaps different language but getting at the same point.

Q. Let me put the question this way. If a 12 percent return on market value is reasonable, as you suggest, then rates of return on the book value of different companies will vary according to whether the market price of the common stock was more or less than the book value under your theory?

Now, that necessarily follows, does it not, from what [fol. 6984] you have heretofore testified?

The Witness: May I have the question read back, please?)

(Whereupon, the pending question was read by the reporter.)

The Witness: Yes, I think so.

By Mr. Littman:

Q. Now, you stated a moment ago that it so happened that the book value and market value of Panhandle Eastern's common stock were almost the same.

A. They closely approximate each other, yes, as of June 30, 1941.

Q. What does that indicate to you, if anything?

A. It indicates that the investors in Panhandle Eastern are stating that they believe the book values in the firm are about even with the market price.

Q. Then the investor does attach some significance to the book value of the common stock of a utility, does he?

A. I think I have stated we consider it but whether or not you attach value to it, Mr. Littman, is exactly what is in the record, that I would not attach value to it until I had analyzed it.

In some cases it may mean everything it says. In other cases, there are write-ups, write-downs and appraisals, any

number of things and without knowing that, book value would not mean a thing, not a thing.

[fol. 6985] Q. Are you suggesting there are some write-ups in the accounts of Panhandle Eastern Pipe Line Company?

A. I do not believe I suggested that, did I?

~~Q. Well, you talked rather generally and vaguely.~~

A. Yes, I am talking about general companies. You asked about "companies." Your own question here says, "companies" and I am saying that you can find, taking companies as a group, the many corporations in this country, that book value, as such, without analysis to see how it has [een] constructed, would mean very little.

I do not know of any write-ups or write-downs or any appraisals in the case of Panhandle Eastern. I made no investigation as to that fact.

Q. Now, you stated at Page 1127 of the transcript of the testimony in this proceeding that "from studies that I have made of numerous other companies, it is seldom that one finds the appraisal made by the market of the total capitalization of a company approximating the book value and, in this particular case, it would indicate to me that the investors believe that the book value here must be an accurate figure."

A. Well, I believe, in different language, that is just what I gave in the recent answer.

Q. Now, I would like to have you state what you mean when you say that the investors believe that the book value [fol. 6986] here must be an accurate figure. Accurate as to what?

A. Accurate as to the component parts of a corporate entity which include the assets, the management and the combination of the two to create ability to earn money.

Those factors are considered in the market price. The investor, having a price on securities outstanding in Panhandle Eastern is saying if those prices add up and give you a total invested capital which is similar to the book value, that he believes the combination of the assets and the management and so forth warrant that value and that is all he is saying.

Q. Well, if the stock sells for less than the book value, what would that indicate to the investor?

A. Let's take a concrete example. Many of the railroads, until recently, when the armament boom came on, were exactly in that fix.

Market prices were considerable under book values and all the investor was saying is, we do not believe the combination of management and these assets can create sufficient earnings to warrant any such price, so that on an earnings basis, the price is what we say it is in the market and that is considerably under what the books say as to book value, and that would be true, not only of railroads but any other corporate entity that has the same [fol. 6987] combination of factors.

Q. Now, if the stock sold for more than book value, what would that indicate to you?

A. That would indicate to me that the investors say that they believe there is a combination of assets and management here creating earning power which warrants a higher price; more potential earning capacity, in other words.

Q. Well, in your opinion, is it easier or less costly for a company to finance where the market price of the stock is above book value than where it is below book value?

A. I think the predominating consideration there, Mr. Littman, is the matter of earnings, earnings record and prospective earnings, and if those show up to give you adequate coverage for interest, preferred dividends and allow a reasonable amount of return on common stock, why, that will be sufficient to float the issue.

Q. Then doesn't it matter what the matter what the market value of the common stock is, or does it?

A. It doesn't matter?

Q. I am asking you whether it matters or doesn't matter what the market value of the common stock is.

A. I guess I have lost the trend of thought there for a moment. In regard to what, as related to what?

[fol. 6988] Q. At any rate, your earnings-price ratios are definitely related to market value, are they not?

A. Yes, indeed.

Q. Of the common stock? A. Yes, sir.

Q. Let us look at Chart No. 19 of Exhibit 65.

Now, you testified yesterday that the earnings-price ratios shown in Chart No. 19 and in Chart No. 20 were calculated by straight mathematical averages. Is that right?

A. Yes, of comparing the earnings per share with the average price per share.

Q. In other words, looking at the upper left-hand portion of Chart No. 19 for the year 1937, your average earnings price figure of 13.51 percent is [simple] the addition of the three figures on the left, divided by 3, is that right?

A. That is correct.

Q. And the same is true for the other years shown on the chart?

A. Yes, that is correct.

Q. Now, by that process, you gave equal weight to each each of the companies shown in this chart for each year?

A. That is correct.

Q. Whether the company is small or large? A. Yes. [fol. 6989] Q. Now, I believe you stated yesterday that in your Exhibit 63 you determined your earnings-price ratios of over-all capital; not by straight mathematical averages, but by weighted averages, did you not?

A. That is correct.

Q. Now, have you ever made a calculation to determine the weighted average of these companies for each of the years 1937 to 1940, inclusive, shown in Chart No. 19?

A. No, I have not because, as I explained yesterday, where you are talking about common stock only, you have a little greater difficulty in talking in terms of a weighted average as against over all capital because there is the question of eliminating the earnings that must be taken out for bonds and [proferred] stocks and, in some cases, participating preferred stocks before you get to common so it is not as simple to take an earnings per common unless you convert it to a per-share basis as it is to do it for over all capital and that is the reason I followed this procedure.

It just is not a simple mathematical procedure.

Q. Well, it is not a difficult mathematical procedure either, is it?

A. Yes, it is much more difficult than doing it for over-all capital because there you take net available for distribution.

[fol. 6990] It is one solid and you can put your hand on it and use it, but for common you cannot do that. There are adjustments that have to be made.

Q. We had no difficulty doing it. At any rate, you did not do it?

A. That is correct, I did not do it.

Q. Now, look at Chart No. 20 and state whether I am correct in understanding that in the lower left-hand portion of that chart you show the earnings-price ratios separately for each of the five natural-gas pipe-line companies and then, on Chart No. 22, you show the mathematical average of those pipe-line companies, the figure of 12.99 percent? A. Yes, that is correct.

Q. And that is for the year 1941?

A. For the current period, 1941.

Q. Will you please turn to your table for Chart No. 20 of Exhibit 65?

Now, isn't it clear that you can very quickly and readily determine the weighted average for those five pipeline companies for the year 1941 from the data shown on this table and also by utilizing the data shown for those companies in Exhibit 64?

A. That part can be done, Mr. Littman, but, as I commented yesterday in discussing this same subject, as I [fol. 6991] recall, it makes a difference as to the nature of the capital structure.

One company has all common stock. Another has 40 or 30 percent in bonds, 20 percent in preferred stocks, and therefore, to get a weighted average of common stocks where you include one company that has all common stock and another company that may have only 20 percent in common outstanding, is not, in our opinion, a sound weighed average. Therefore, we did not use it.

Q. What effect did you give to these differences that you have just described?

A. I took the companies just as their stock was outstanding at a market price and weighted nothing, so far as common was concerned.

Q. So you did not give any effect to this condition either, did you?

A. Yes, I did because if the earnings per share are there on the calculation that is made, I used that figure, obviously, in getting whatever the percentage is shown there.

Q. Now, will you state whether or not the weighted average earnings-price ratio can be readily determined for the five companies shown on your table for Chart No. 20?

A. Yes, I can take the earnings there shown per share and multiply it by the number of shares outstanding.

[fol. 6992] Q. You do not even have to do that. All you would need to do would be to total your amount shown for common stock as shown in your second column of figures—

A. (Interposing) That is correct, I can do that.

Q. So that is not a very difficult calculation, is it?

A. No, I can make that one but I still say it has a serious question about it.

Q. Well, what you would get by such a weighting process is the figure that you would get if one person owned all of these shares of common stock of these five companies, is that right?

In which event, if that person, to ascertain his earnings-price ratio, would add up all of the earnings available and divide into that figure the total market value of all of his stocks, then that individual could determine the total earnings-price ratio?

A. So far as his holdings of one share each was concerned, yes.

Q. I am assuming that this individual owns all of the common stock.

A. Of all of the five companies?

Q. Of all five companies. That is what he would do, isn't it? A. Yes.

[fol. 6993] Q. And if he did that, he could tell how much he has earned, isn't that right?

A. That would be his percentage return.

Q. He wouldn't take the five companies and determine what the average was for each separate company and divide by five, would he?

A. No, he would not have to there, since he owned them all, but that does not happen to be the fact nor is it probable it will ever be for some time to come.

Q. Of course, I am making an assumption here for the purpose of pointing out the effect of a weighting process and the logic of using a weighted figure.

Now, that is what such an individual would do, isn't that correct, add his total earnings and divide that by the total market value of his shares?

A. That is what an individual could do. Whether he would do it, I do not know, because we serve clients all the time and they are getting the figures both ways and they are adding them up both ways.

Q. Let's see what figure we would get when we give effect to weighting these figures. I shall read them into the record and I shall ask you to check them at your early opportunity.

A. I do not have to work it out now?

Q. No, I wouldn't work them out now because it would [fol. 6994] take some time.

Looking at Chart No. 19—I might say that in each and every instance, the weighted average figure is below the mathematical average figure which you used and that is obviously so because of the fact that the companies that have the highest earnings-price ratios, as shown on this chart, are given greater weight and effect in the answer when you simply take the mathematical average—.

Now, looking at the year 1937 in Chart No. 19, the weighted average figure is 11.83 percent in place of the 13.51 percent which you have.

For the year 1938—and, by the way, I am writing these figures immediately above the orange column—in 1938, the weighted average figure which we have secured by the use of your charts and figures and Exhibit is 12.12 percent in place of 13.45.

For the year 1939, the weighted average figure is 11.04 percent instead of the 13.28 percent.

For the year 1940, the weighted average figure is 12.56 percent in place of the 13.82 percent.

Mr. Wheat: Are you going to give another figure for 1941?

Mr. Littman: I was just going to go to the green bar shown in Chart No. 22—what did you want, an average figure for all of the years?

[fol. 6995] The Witness: I thought that was what Mr. Wheat—

Mr. Wheat: (Interposing) No, I wanted you to state for the record just how you arrived at your weighted averages so we would know what you did, Mr. Littman.

We are a little dubious here as to what you did.

Mr. Littman: I shall be glad to furnish Mr. Coffman with our working papers.

Mr. Wheat: No, I would like to have you explain it on the record, if you would, so that not only Mr. Coffman but ourselves would know what you did.

It must be a simple calculation if you take just one of them, 1937, where there are only three figures, for example, and tell us what you did, then we would know more what you mean by that 11.83 that you give us.

By Mr. Littman:

Q. Now, turning to Chart No. 22, the green bar shows 12.99 percent on the chart as the average of the pipe-line companies.

I believe you testified yesterday that this 12.99 percent is a straight mathematical average, is that right, Mr. Coffman?

A. I do not have that calculation. I believe that it was.

Q. Well, if there is any doubt about it, I think we ought to establish that now.

[fol. 6996] A. I am getting the figure [the figure] here.

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[fol. 6997] The Witness: Yes, it is an arithmetic figure.

By Mr. Littman:

Q. The weighted average figure that we have for the "average of pipe-line companies" for Chart No. 22 is 12.21 percent as compared with your mathematical average of 12.99 percent.

In addition to that, Mr. Coffman, we have made a computation to determine the weighted average for pipeline companies, including the Northern Natural Gas Company, and we have included in this calculation the earnings figure after giving effect to the 1941 Federal taxes.

The earnings figure for Northern Natural Gas Company which we use is $3,306,260 and the weighted average for those six companies, to-wit, Interstate Natural Gas Company, Memphis Natural Gas Company, El Paso Natural Gas Company, Southern Natural Gas Company, Panhandle Eastern Pipe Line Company and Northern Natural Gas Company, based on the 1941 market prices, is 11.73 percent.

Now, I am going to ask you to check those earnings-price figures and report back with respect to their accuracy when you return here next Monday.

A. Yes, I can do that.

Q. Now, I would like to briefly state on the record [fol. 6998] the method that we have used in weighting. We have totaled the market value of the common stocks for these companies for the periods shown and have divided that total into the total earnings available for common stock for the same period, all of these figures having been taken from your Exhibits 65 and 64.

Will you please refer to Chart No. 22, Mr. Coffman, and state whether the 12 percent estimated cost for new financing to Panhandle Eastern Pipe Line Company shown in the right-hand side of that chart reflects the 1941 Federal tax rate?

A. Yes, I think it has been taken into consideration.

Q. Now, state whether or not any of the earnings-price ratio figures which you show in Chart No. 20 reflect the 1941 tax rate?

A. As I recall it, those figures do not take in the 1941 rate. They were the actual earnings reported by the companies for the 12-month period ended at various dates, as shown on table for Chart No. 20, Exhibit 65.

Q. Panhandle Eastern's earnings are shown for the 12-months' period ended June 30, 1941, is that correct?

A. Yes, that is correct.

Q. And the same is true of Southern Natural Gas Company and El Paso Natural Gas Company, is that right?

A. That is correct.

[fol. 6999] Q. That leaves two companies shown on Chart No. 20 whose earnings were taken for the full year 1940, isn't that right?

A. The full calendar year 1940, yes.

Q. Now, if you had reflected or had given effect to the increased Federal taxes attributable to those earnings of El Paso Natural Gas Company, Southern Natural Gas Company and Panhandle Eastern Pipe Line Company for the six months ended June 30, 1941, you would have shown lower earnings-price ratios, isn't that true?

A. Yes, with that adjustment they would have been lower.

Q. And, of course, that would have lowered the 12.99 percent average of pipe-line companies shown by the green bar in your Chart No. 22 of Exhibit 65?

A. Yes, it would have an effect on that figure.

Q. Both on the straight mathematical average basis or on the weighted average basis, isn't that correct?

A. That is correct.

Q. As a matter of fact, you show in the case of the Northern Natural Gas Company by Chart No. 21, the effect of the increased Federal taxes for the year 1941 upon the earnings-price ratio, do you not?

A. That is correct.

Q. It falls from 11.72 percent to 10.38 percent as shown [fol. 7000] in the lower right-hand portion of the chart as "Based upon price to public", is that correct?

A. That is right.

Q. And that figure of 10.38 percent which I just read, after 1941 taxes, for Northern Natural Gas Company does not give effect to any further increases in taxes which you have stated are to be expected in the year 1942?

A. Not as of the date of that calculation.

Q. Now, while on the subject of Chart No. 20 of Exhibit 65, I note that the Southern Natural Gas Company has the highest earnings-price ratio of the companies there shown, to-wit, a ratio of 17.27 percent, is that right?

A. That is correct.

Q. And looking at the preceding chart, No. 19, Southern Natural Gas Company stands out like a sore thumb in the years 1940, 1939, with earnings-price ratios of 20.13 percent and 21.59 percent, respectively, isn't that right?

A. That is correct.

Q. That is, they are head and shoulders above the other four companies there shown?

A. Yes, those figures are larger.

Q. Now, did you investigate the cause or causes for Southern Natural Gas Company's high earnings-price ratios in the years shown in Charts Nos. 19 and 20?

[fol. 7001] A. No, I did not. I calculated the figure based upon the earnings per share as reported and the average of the high and low prices.

Q. Weren't you interested in what produced this result which affected so heavily your average for the various periods?

A. In this particular case, I was merely interested to see what the investors were saying about the individual companies which were included and whatever the market price, whatever the average of the market price was and the earnings were, I made my calculation.

Q. What reliance would an investor put upon earnings-price ratios such as those shown for Southern Natural Gas Company in Charts Nos. 19 and 20 for the years 1939, 1940 and 1941, without making an investigation?

A. No doubt the investors did make the investigation and through that determined the price which I used but I did not make the investigation.

Q. But this situation, with respect to Southern Natural Gas Company, as reflected by its earnings-price ratios, does and did have an important bearing upon your ultimate conclusion as to Panhandle Eastern's estimated cost of new financing for common stock, did it not?

[Q.] Well, the Southern Natural Gas figure was included and, naturally, to the extent that it was included [fol. 7002] it had some bearing on the result but so far as

my analysis is concerned, investors not only look at a given company but they also look at the industry to see what the trend is and, therefore, if Southern Natural is a part of this industry it has to be taken into consideration and I included it in the list.

Q. Well, when investors are about to invest their money in the securities of Panhandle Eastern, how much weight do you think they would give to any such earnings-price ratios as those shown for Southern Natural Gas Company in these charts?

A. The investor does, I think, pretty much what we do. We study the industry and try to find out as much as we can by studying the history of the various companies.

If there are a number of companies in a particular industry which are having difficult times and so on, we know that it has a definite influence on the investor's thought so that he would give attention to this and if there were two or three similar situations in the natural-gas pipe-line industry, he would give that pretty considerable weight.

Q. You gave it more weight than you gave any other company, isn't that right?

A. I gave it a weight of one in the total of the number of companies shown.

[fol. 7003] Q. Well, inasmuch as it had a much higher earnings-price ratio than any of the other companies, it did get much greater weight than did the other companies, did it not?

A. That is correct but I had no way of weighting it otherwise. I mean it was one company along with Interstate and the rest.

Q. Well, before using the earning-price ratio of Southern Natural Gas, weren't you interested in ascertaining first whether that company was properly comparable to Panhandle Eastern Pipe Line Company?

A. No. In this study I tried, as I think I explained, to include every company upon which there were data available to make the calculation and so far as my ability permitted, I believe I have done that.

Q. In your opinion, is Southern Natural Gas Company comparable to Panhandle Eastern Pipe Line Company?

A. I do not think it is and I do not think I am saying that it was.

This is 21.59 percent in 1939 and 20.13 percent in 1940, and I am not talking in those kind of terms at all for Panhandle Eastern so I do not say that it is comparable but it is, nevertheless, a natural-gas pipe-line company and investors very definitely look at it along with the rest and if there were a number having the same experience as Southern Natural, I think the investors would be on the [fol. 7004] whole a little skeptical of it as an industry in which to place money.

Q. If you had excluded Southern Natural Gas Company from your average, you would have certainly secured an average for pipe-line companies considerably below 12.99 percent, would you not?

A. Yes, and, on the other hand, if I had left Southern Natural in and excluded Interstate Natural, I would have gotten a much higher percent so I included both Southern and Interstate.

Q. You have no basis of comparison, either—

A. (Interposing) In this particular case where I am trying to secure the investor's appraisal of risk in so far as data are available on all companies to get the investor's appraisal, they should all be included.

Q. So you threw all the good ones in and all the bad ones in, added them and divided by the total?

A. That is what the investor says is the industry and what it is doing as an industry, yes, absolutely.

Q. Why didn't you throw a few of the bankrupt companies in here while you were at it, because the investor is always fearful that that might occur some day, sometime, somehow, isn't that correct?

A. The difficulty is, on companies of that kind, you usually find that the data which I am talking about is [fol. 7005] not available.

There were no quotations available to make calculations or the earnings are so tied up in bankruptcy proceedings that you do not have those, so you are unable to make the calculation for lack of data.

Q. You think then, that the consumers and customers of Panhandle Eastern Pipe Line Company should pay a higher return for their service, a higher price for the service rendered by Panhandle Eastern Pipe Line Company

simply because some other companies in the industry have had some difficulties in the past or have been in hot water from time to time. Is that your testimony?

A. I do not believe I said that, did I?

Q. I am asking you whether that is your testimony. That seems to be the effect of it.

A. I do not believe it is. What I am saying is that investors, to the best of their ability, review the trends in the industry which includes all of the companies operating therein upon which they can secure data.

Q. Now, do you think that the natural-gas customers of Panhandle Eastern Pipe Line Company should pay higher rates simply because Southern Natural Gas Company has an earnings-price ratio in excess of 20 percent?

A. Let me answer again—

Q. (Interposing) Can you answer that yes or no?

[fol. 7006] A. No, I do not think I can.

Q. You have some doubts about that, have you?

A. No, I do not think your question is complete so that it can be answered that way. What I have been saying right along is that the investors are appraising the risks of capital in this business to the best of their ability and in so far as they require a certain earnings-price ratio be willing to have their capital invested in this business, the ratio so found pretty much is an indication of what they say.

Now, if the customers, on the other hand, have different ideas about this service, then it seems to me that the only way to settle that is for them to determine that they should not get their money from the public but, perhaps, get it from the Government, in which case, then, we have no worry about the investors at all, but if they are going to rely on public financing, then they must take these various matters into consideration which the investors take into consideration before they will invest their money or not.

Now, it can be done either way, it seems to me, but so long as a private person's capital is in this business he, naturally, wants to have some say about that capital and if it is going to get to a point where the company will not be permitted to make earnings sufficient to give him se-[fol. 7007] curity of principal and a return, no doubt he

will withdraw it and at that time the Government can finance it.

At least, that is one other possibility of financing.

Q. Well, you are not suggesting that your method is the only method that could be properly adopted for ascertaining the rate of return for rate-making purposes, are you, Mr. Coffman?

A. I have never said that in these proceedings, but I have said that I thought it was one indispensable part of such consideration.

Q. Of course, when you begin to get results like these, it might suggest that something is wrong with this method, might it not?

A. I do not think any more so than with the classical theory where, under that procedure, you find that there seem to be difficulties in the results that have been had over the years.

Q. Will you tell me why the customers of Panhandle Eastern Pipe Line Company should pay more for gas simply because another natural-gas company got into a jam at one time or another?

A. I do not think they are paying more. As I indicated here in Southern Natural, the percent was 21.59, as I remember it.

[fol. 7008] The figure I am talking about is 12 and that is based upon the trends in the industry and the peculiarities of the Panhandle Eastern Pipe Line Company.

Q. Yes, and you arrived at that 12 by giving great weight to this Southern Natural Gas Company's earnings-price ratio because it was included in your average, was it not?

A. I am not giving it great weight, I am giving it the weight of one in the amount of the figure that is shown there.

Q. You are giving it as much weight as if it were strictly comparable to the Panhandle Eastern Pipe Line Company?

A. That is right, because the investors placing money in this industry believe it must be a little more hazardous than others or such companies wouldn't be in such difficulty.

Q. Now, suppose Southern Natural Gas Company had an earnings-price ratio of, let us say, 75 percent. Would you average it in with the rest of the companies and use the average, the straight mathematical average of those companies as a guide for you in determining the amount of earnings to which Panhandle Eastern is entitled on its common stock?

A. Well, I think the answer there is "no", because [fol. 7009] the earnings, presumably, under such a situation are approaching zero, in which case there would be some reason for eliminating it.

Q. Well, there are some companies throughout the length and breadth of this land that are in that kind of a predicament. Isn't that right?

A. That is correct, there are companies of that sort.

Q. You wouldn't think of penalizing the customers of other companies simply because some were in that kind of a jam, would you?

A. Well, as I say, this is just one firm that has been included, and the figure that was included here is not 70 percent or 75 percent, as you are talking about, it was 20, which was not so much far out of line with other companies.

It was higher, very definitely, but not so much out of line as to be ridiculous.

Q. Do you know what the figures were for Southern Natural Gas Company for the years 1937 to 1938?

A. In earnings figures?

Q. Yes, which earnings figures are not shown in your Chart No. 19.

A. No, I do not have those figures.

Q. Well, the net effect of your method is to reflect in the rate which you have estimated for Panhandle Eastern [fol. 7010] the earnings-price ratio of Southern Natural Gas Company, among others, as shown in your Charts Nos. 19 and 20, whatever the cause for that rather high earnings-price ratio for Southern Natural Gas Company.

The Witness: Will you read that please?

(Whereupon, the pending question was read by the reporter.)

The Witness: Well, only partially so, Mr. Littman, as you know from the exhibits because, as I stated, the 12 percent which I used was a judgment figure which was not based directly on the 12.99 percent as I calculated it by my method which included the Southern Natural, so that there has not been an undue weight given to Southern Natural by any manner of means.

By Mr. Littman:

Q. Well, you did not shave off the .99 percent because of any situation which prevailed with respect to Southern Natural Gas Company, did you?

A. No, I was talking about Panhandle Eastern and giving my best judgment as to about what that company would have to expect in the market.

Q. Using the average of the El Paso Natural Gas Company, Interstate Natural Gas Company, Memphis Natural Gas Company and Southern Natural Gas Company as a guide?

A. As one of the guides, yes. That is one of them.

Q. Well, to the extent that you did consider that aver- [fol. 7011] age figure your ultimate judgment rate, the 12 percent does reflect the Southern Natural Gas Company's earnings-price ratio. Isn't that right?

A. I will answer again, partially so and no more for this reason—

Q. (Interposing) Well, I said, "to the extent" and I thought I stated exactly what your exhibit shows,

A. Well, maybe I am being a little too technical here, but as I visualize it, if you have five companies, one of which is a little larger in its earnings-price ratios than another, dividing by five to begin with carries only one-fifth of that overage of weight, as you would like to describe it.

Then in addition to that, I had the 12.99 and took 12, so there is a further amount out, so that when you say that you give it great weight, as you were talking about, I just want to get my answer correct that I do not think that it was given great weight.

My answer does not give it great weight.

Q. When I used the term "great weight", I was referring to the average figure of 12.99 percent, which aver-

age includes Southern Natural Gas Company. Didn't you so understand it?

A. No, I thought you were talking about the over-all picture.

[fol. 7012] Q. Well, let's look at Chart No. 19 for the year 1940.

Now, you gave Southern Natural Gas Company more weight than both El Paso Natural Gas Company and Interstate Natural Gas Company, combined, didn't you, for that year?

A. Just slightly more weight, yes.

Q. Do you know where Southern Natural Gas Company secures its gas supply?

A. Yes, as I recall it, it secures it in the general territory of the Amarillo region, I believe.

Q. In Texas? A. I believe so.

Q. How long has that been going on? Before you look up that matter, Mr. Coffman, you are unable to answer that without making a reference to some publication or other?

A. That is right, I want to check my recollection.

Q. And you are now examining Moody's?

A. Moody's Manual, yes, sir.

I do not know, from what I have read here; at this point the only information I see in Moody's in regard to your question is in connection with the statement that the company formerly owned a half-interest in the Georgia Natural Gas Company which it disposed of in 1937 and in 1939 leases on approximately 1100 acres in the Tinsley Field near Yazoo City, Mississippi, were acquired.

[fol. 7013] The company has assigned these leases to an oil operator for development, containing a normal participation of one-fourth in the proceeds of all wells drilled.

I would have to check those facts to answer the matter. I cannot tell you correctly.

Q. Mr. Coffman, you are interested, are you not, in the pronouncements of the Securities and Exchange Commission with respect to various utilities and you keep currently abreast of the opinions and findings of that Commission with respect to the industry?

A. Yes, we try to following all those releases.

Q. Well, I read you from the findings and opinion of the Securities and Exchange Commission, Holding Company Act Release No. 2476 dated January 10, 1941, in the matter of Southern Natural Gas Company and Federal Water Service Corporation as follows—I might state before quoting this that wherever the term "Southern" is used the reference is to Southern Natural Gas Company:

"Southern is presently required to purchase all of its supply of gas in the Monroe Field under contracts with certain producing companies. Such contracts which extend until December 31, 1949, obligate each seller to deliver gas to a specified maximum amount in any day (which amounts aggregate 162,500 M.c.f.), subject to the sellers having gas available from the Monroe Field and subject, [fol. 7014] also, to the reservation by the sellers of such gas for certain purposes, including the delivery of gas to the pipe lines serving St. Louis, Memphis, New Orleans and Shreveport. The contracts permit the sellers to deliver gas from other fields and provide that, in the event the sellers do not have available gas to supply Southern's requirements, Southern may purchase or otherwise obtain gas from any source to supply such deficiency.

"The Monroe Field is not expected to produce gas in sufficient quantities to meet peak demands for more than three or four years. Since August 1, 1940, Southern's wholly-owned subsidiary, Southern Production Company, Inc. (Production Company) has entered into agreements with the holders of gas and oil leases in the gas producing area known as the Logansport (Joaquin) Field, located partly in Western Louisiana and partly in eastern Texas about 135 miles west of the Monroe Field, providing for the assignment to the Production Company of the gas rights in leases covering an aggregate of approximately 11,000 acres. About 3,220 acres of this land is located within the proven area and comprises about 27 percent of the proven area.

"In order to relieve itself of the limitations of its existing gas purchase contracts with producers operating in the Monroe Field, Southern has for some time been carrying on negotiations with these producers looking toward

[fol. 7015] the execution of new gas purchase contracts, to extend until December 31, 1949, which will provide that Southern will purchase from the present producers specified percentages, aggregating initially 75 percent, of the requirements of its system, the remaining 25 percent to be purchased or otherwise obtained from any source. The price payable for all gas will consist of a commodity charge of 5 cents per M.c.f. plus a demand charge of $4.20 per M.c.f. per year on the maximum number of M.c.f. provided to be delivered in any day during each year. If the proposed new contracts had been in effect during the 12 months ended August 31, 1940, the price paid for gas would have been 6.59 cents per M.c.f. instead of the average price of 5.63 cents per M.c.f. paid under the present contracts, an increase of $418,942."

Now, I ask you, Mr. Coffman, whether you have ever read that part of the Release of the opinion and findings of the Securities and Exchange Commission?

A. No, I have not.

Q. Now, the fact which I have read, that the Monroe Field from which this company, to-wit, Southern Natural Gas Company has been securing its gas supply is not expected to produce gas in sufficient quantities to meet peak demands for more than three or four years would have what effect upon the earnings-price ratios of Southern Natural Gas Company?

A. Well, it would tend to make the price ratio rise.

[fol. 7016] Q. And that factor clearly has something to do with the Southern Natural Gas Company's earnings-price ratio which exceed 20 percent, as shown in your charts?

A. I think the investors have given weight to that.

Q. Now, what do you say about the effect on the earnings-price ratios of Southern Natural Gas Company because of the fact that they were confronted with a situation under which they would have to pay $418,942 more for gas, as I have read from the opinion, than they had paid in the previous year? What effect would that have upon the earnings-price ratio?

A. Well, investors would try to appraise the situation as best they could and if there is a question about the risk, the tendency would be for it to rise under the pres-

ent situation, but that, I think, is in line with what I said a few minutes ago that investors in this industry study that type of situation because they would want to find out whether Panhandle Eastern, for instance, might not have some trouble along the way in the same kind of situation.

Q. Are you still of the opinion that Southern Natural Gas Company—

Mr. Culton: (Interposing) Just a minute. Don't you think, in view of your question, you should also ask if he thought the investors would take into consideration the [fol. 7017] opinion of Ralph E. Davis as to the life of that field since it is in the same one?

Mr. Littman: Mr. Culton, you are at liberty to read any part of that finding you wish to read which you feel is material.

Mr. Culton: I do not think any of it is material, but I just happened to notice that that same thing says that Ralph Davis' estimation was for the supply at 1949 instead of for three or four years.

Mr. Littman: I will read this part into the record, if you will—

Mr. Culton: (Interposing) I do not think any of it is material, but I thought if you were going to ask the witness if he thought he should take the three or four years into consideration—

Mr. Littman: (Interposing) Of course, Mr. Davis is not speaking of peak loads, and my questions after reading this report, had to do with peak loads.

I think the record will show you did not hear me. The question that I put to this witness was related to the fact that the Monroe Field is not expected to produce gas in sufficient quantities to meet peak demands for more than three or four years, however, I think I had better read the other statement into the record.

Mr. Wheat: Did you, Mr. Littman, also, read in the [fol. 7018] statement from that opinion that the Southern Natural was obtaining an additional gas supply? I believe you did.

Mr. Littman: Yes.

Mr. Wheat: And I would suppose that you would ask the witness whether that was possibly responsible for the reduction in the earnings-price ratio for Southern Natural in 1941. I do not know.

Mr. Littman: But they are obtaining it an an increased cost of $418,000 a year.

Mr. Wheat: I am not talking about the other, Mr. Littman, at the Monroe Field. I am talking about that which they are obtaining out of the Logansport and the Joaquin Field which was gone into at such length in the application of Tennessee Gas and Transmission Company.

By Mr. Littman:

Q. Well; do you know anything about these facts that we have been discussing?

A. Not for purposes of this study, because I have described exactly how I prepared the study. I took the prices and I took the earnings as were reported.

Q. Then you do know that the earnings-price ratio shown for Southern Natural Gas is unusual, do you not?

A. It is larger or higher than for the other companies shown.

Q. And reflect certain fears, do they not?

[fol. 7019] A. They must reflect that in the minds of the investors.

Q. Now, whether or not I have given you all the fears that are reflected in the mind of the investor or not, of course, I do not know, but you do know that there must be something akin to fear in the mind of the investing public who are investing in the common stock of Southern Natural Gas Company in order to have an earnings-price ratio in excess of 20 percent. Isn't that right?

A. I think the investors by having this higher priced ratio indicated that there is a greater hazard in Southern than in the other companies listed.

Q. And we are agreed, are we not, that you did not make any investigation to ascertain precisely what those hazards were?

A. That is correct, for this study.

[fol. 7020] By Mr. Littman:

Q. Mr. Coffman, before proceeding with this line of inquiry which I suggested just before the recess, will you please state whether you have made the calculation with respect to the 1941 Federal income and excess profits taxes on the $1,000,000 of gross revenue concerning which we have heretofore discussed?

A. Yes, I have.

Q. Now, will you please state the results of your tabulation?

A. On the assumption of a ~~reduction~~ in rates which would total $1,000,000 in gross, there would be a change in the Federal income tax and excess profits taxes, based on the 1941 rates, so that the net operating income would be $276,000 less or out of a million-dollar reduction there is less than 30 cents change in net, which I believe was the way—

Mr. Culton: (Interposing). Out of a dollar reduction?

The Witness: (Continuing) Out of a dollar less than 30 cents, which I believe is the way you originally asked the question.

Mr. Wheat: Did all the difference represent taxes that would be lost to the Government?

The Witness: Yes, sir, that is correct.

[fol. 7021] Mr. Wheat: How much is that?

The Witness: That would be $724,000.

Mr. Wheat: Thank you.

By Mr. Littman:

Q. Now, I would like to have you assume a bond in the principal amount of $1,000 selling on the market at $105, that is, $1,050, which is commonly referred to as one thousand and five, and having a coupon rate of 4 percent with a maturity date of 15 years hence.

A. How much was the coupon rate, please?

Q. Four percent.

Now, am I correct in understanding that the "current yield" on that bond is determined simply by dividing 4 by 105 to get 3.81 percent?

A. That is the current yield, yes.

Mr. Wheat: How do you do that now?

Mr. Littman. Divide 4 by 105.

By Mr. Littman:

Q. Now, the "yield to maturity" is always less, is it not, than the current yield?

A. That usually is correct, I mean it would depend on whether your bond is selling at a premium or discount and so forth.

Q. Well, that would always be true where the bond is selling at a premium, isn't that correct?

[fol. 7022] A. Yes.

Q. And the premium in this instance is $50?

A. Yes.

Q. Now, am I correct in stating that the amount by which the yield to maturity is less than the current yield is dependent upon and governed by, first, the number of years to maturity and, secondly, the amount of the premium?

A. That is correct.

Q. And is it also true that if the premium is large the yield to maturity will be substantially less than the coupon rate or the current yield rate?

A. Yes, generally.

Q. Now, it is a well-recognized fact that these yields to maturity are always a vital factor considered by the investor?

A. Yes, he considers those and refers to yield books, bond tables and so on.

Q. And it is a fact that the yield to maturity represents the investor's real yield. Isn't that right or actual yield?

A. Yes, that is right.

Q. Now, the investor who wants to ascertain the true return upon his investment must use bond tables to make the tabulation, must he not?

A. That is correct.

[fol. 7023] Q. Now, this same situation obtains with respect to preferred stock having a sinking-fund provision which sells at a premium, isn't that true?

A. That would be correct.

Q. And it would, also, be true, would it not, of preferred stock that is not callable until a certain date?

A. The investor would take into consideration the call price, that is, the closer you approach the callable date he would take that into consideration.

Q. That is to say, he would amortize his premium and give effect to the premium in determining his true yield. Isn't that right?

A. That is correct. Presumably as the callable date approached, the price, if it had been in excess, would have begun to come down near or at the level of the callable price.

Q. Now, I want you to assume a preferred stock having a par value of $100 callable 10 years from date at 110 and I want you to further assume that this stock has a dividend rate of 5 percent and is presently selling on the market at $120.

Now, isn't it a fact under these circumstances that the investor amortizes out of his dividend the premium of $10 over the 10 years. It that right?

A. Yes, that is correct.

[fol. 7024] Q. Another way of stating the situation is that he receives $50 over the 10 years in dividends but he only considers $40 of this total $50 dividend payment as his real income, doesn't he?

A. That is correct.

Q. Because he had to take $10 from the proceeds of his dividends to write off the premium?

A. That is correct.

Q. Now, let's assume that we have some common stock of the Natural Gas Pipe Line Company and now we are speaking of common stock and I want you to assume that this Natural Gas Pipe Line Company has a finite life of 15 years.

I would also like to have you assume that this stock has a book value of $10 and is selling on the market at a price of $20. I would like to have you further assume that this

hypothetical pipe line company is fortunate enough to be earning 10 percent per annum on the market price of this common stock or $2 per share throughout the entire 15 years of its life and I want you to assume that this $2 dividend is paid each year throughout the 15 years.

Now, this $2 per share of earnings represents 20 percent of the book value of the common stock, does it not?

A. Twenty percent of the book value?

Q. Yes.

A. Yes, that is correct.

[fol. 7025] Q. Now, let's look at the picture 15 years hence when the gas supply is exhausted and the company winds up its affairs and goes out of business.

Now, the stockholder has received $2 per share for 15 years, a total of $30 in dividends, has he not?

A. That is correct.

Q. He gets back $10 in liquidation at the end of the 15 years because the company has wound up its business and has paid off the book value to the stockholder. Do you get that?

A. Yes.

Q. So that he has received $30 in dividends plus $10 in liquidation, a total of $40, is that correct, over the 15 years?

A. He gets in liquidation $10 in addition to the $30 he receives, so he received a total of $40?

Q. Yes.

A. That is right.

Q. Now, you understand that this investor's original investment was $20 in this share of stock, was it not?

A. Yes, it was.

Q. What was this investor's true earnings on this share of stock for the 15 year period during which he held it?

A. Are you now asking for dollars or for percentage?

Q. Dollars.

[fol. 7026] A. Well, he received altogether 100 percent on his original investment.

Q. Well, I asked you for dollars.

A. Well, $20.

Q. His true earnings are $20, is that right?

A. That is the amount he received in excess of his original cost.

Q. Now that true earnings of $20 is $1.33 per year, ~~is~~ it not, dividing the $20 by 15 years?

A. That is approximately right. I haven't figured it. ~~Yes, that~~ is correct.

Q. And expressing this true return upon investment in terms of percent, it amounts to $6\frac{2}{3}$ percent, does it not?

A. Yes, that is correct.

Q. Now, may we not agree under these circumstances that the true appraisal of risk by this investor is $6\frac{2}{3}$ percent? A. Yes, that is correct.

Q. Now, if this company were shown in your Chart No. 19 or 20 of Exhibit 65, the earnings-price ratio of this company's common stock would be shown at 10 percent, would it not, and you would term that 10 percent the "earnings-price ratio" or "investor's appraisal of risk"?

A. That is correct.

[fol. 7027] Q. Notwithstanding the fact that this particular investor has received a true earning of $6\frac{2}{3}$ percent?

A. Well, that is correct except in the assumption we have only got one thing straight at this point, that here you are talking about the thing being wound up and all facts known, whereas in this study it is impossible to do that. With that one exception, I agree with what you have said.

Q. Well now, under the set of facts which I have asked you to assume, it is clear, is it not, that this particular investor having paid $10 more than the book value of the stock had to amortize that $10 premium over the 15 years during which he held the stock, isn't that right?

A. That is right, he can do that.

Q. And in order to amortize that $10 bonus that he paid or premium that he paid, he had to do that out of the annual dividends that he received, did he not?

A. He had to make allowance for it in that calculation.

Q. And in order to determine the true yield to the investor you simply have to take into account the fact that he had to amortize this premium out of the total dividend which he received.

A. That is correct.

Q. Very well. In arriving at your 12 percent cost of [fol. 7028] common stock for Panhandle Eastern Pipe Line Company, you stated yesterday in your testimony that you have given considerable weight to the cost of financing Northern Natural Gas Company's common stock, which was offered to the public on September 10, 1941, the facts of which are shown in Chart No. 21 of Exhibit 65 and in the table for Chart No. 21. Isn't that right?

A. That is correct, I considered that.

Q. You considered it and gave it great weight?

A. And gave it weight in my calculation of 12 percent, yes.

Q. Would you say great weight?

A. I do not recall that I did, I gave it weight. I mean I am always fearful when you use these "greats" because they are relative terms. Just how great do you mean?

Q. Well, what would you say in characterizing it?

A. Well, I gave the weight along with these other items and because it was a recent financing of a natural-gas pipeline company, I thought it was pertinent to put it in but, in other words, I cannot tell you that I gave it 40 percent weight and something else 20 percent and so on.

My figures of judgment are a figure taking all these factors and forming a judgment.

Q. Well, it certainly entered into your judgment in arriving at this 12 percent estimate?

[fol. 7029] A. Yes, it did.

Q. Well now, what did Northern Natural's common stock sell for as shown by your Chart No. 21?

A. It sold to the public at $31.40.

Q. There seems to be some controversy as to the exact selling price due to a 60-cent dividend that was declared in 1941, is there not?

A. Well, this price that I mentioned is ex the dividend, it excludes the dividend.

Q. As a matter of fact, they did pay a 60-cent dividend and the prospectus of Northern Natural Gas Company for this common stock shows the price per share, including the dividend, at $32, does it not?

A. Yes, that is correct.

Q. Well, I merely wanted the record to show that the price that you have used here is exclusive of the 60-cent dividend.

A. It is exclusive.

Q. Well, at any rate, the price to the public, exclusive of the dividend, was $31.40, as shown by you in Chart No. 21, of Exhibit 65?

A. Yes, it was.

Q. At the time of the sale, what was the book value of this common stock per share? Can you answer that?

A. I don't believe I have that figure, but I will check. [fol. 7030] Q. Mr. Coffman, I hand you a copy of the prospectus of Northern Natural Gas Company for the 355,-250 shares of common stock par value, $20 per share, which covers the stock issued shown in your Chart No. 21 of Exhibit 65, and I refer you to page 4 of this prospectus and particularly to the insert on that page, which I believe will give you the book-value figure.

A. Well, the amount stated here is $22.78 per share, but there are qualifications so that it probably would be better to read the whole statement to have it actually in the record.

Q. Suppose you read the entire statement.

A. On Page 4 of this exhibit—

Q. (Interposing) This is not an exhibit in this proceeding.

A. (Continuing) This prospectus, under the caption, "Net Tangible Asset Value," which is an insert to Page 4, it states as follows:

"Based upon the consolidated balance sheet of the company and subsidiary companies as of June 30, 1941, as shown in this prospectus, the net book value of all assets other than intangible assets, prepaid insurance, rentals and so forth and deferred charges, less long-term debt, current liabilities, reserves for depreciation, depletion and insurance and contributions in aid of construction amounted [fol. 7031] to $23,123,531.65 at that date which is equivalent to approximately $22.78 per share on 1,015,000 shares of common stock now outstanding. Neither the company nor the underwriters represent that the amounts at which assets are stated in the balance sheet represent the realizable or fair market value thereof or that the amount of $22.78 per share would be available upon liquidation of such assets and after discharge of the company's liabilities."

Q. You are satisfied from the reading of this portion of the prospectus that at the time of the sale the book value of this common stock was $22.78 per share. Right?

A. Yes, in accordance with that statement.

Q. Now, an investor buying a share of common stock of Northern Natural Gas Company would have to amortize the amount by which the price of $31.40, which he paid for the stock, exceeds the book value of $22.78 of this stock, to-wit, the difference of $8.62 over a period. Isn't that right?

A. May I refer to that again before I answer please?

(A document was furnished the witness.)

The Witness: I think there is some question there, Mr. Littman, I would suppose it would be better to consider the par value of $20. After all, that is all the firm commits to pay upon liquidation regardless of what the book [fol. 7032] value was at the time.

By Mr. Littman:

Q. Very well. Let's take the $20 as the amount which the firm will pay upon liquidation when the gas supply is exhausted.

I understand that Northern Natural Gas Company also has a finite life, does it not, inasmuch as it relies upon a natural resource?

A. That is right, it has reserves which will be exhausted.

Q. Now, this investor in a share of common stock of Northern Natural Gas Company has to somehow get back this $11.40 which he has paid over and above the par value of the share of common stock. Isn't that correct?

A. That is correct.

Q. Now, the only way he has of getting that $11.40 premium back is by amortizing that amount over a period from the total dividends which he receives, isn't that right?

A. Well, that is one way of doing it, except that we must still take into consideration that the common-stockholder, unlike the callable preferred holder and the bondholder, has no time except the life of the company.

In other words, his problem is considerably different than a call date in case of preferred or a maturity date in

case of a bond, and yet you were trying to draw an analogy [fol. 7033] here which would put this in that class.

On an assumption I am perfectly willing to go along with it, but I just want to have it clear that there are wide differences between the types of securities.

Q. Well now, let's suppose that you were an investor in Northern Natural Gas Company's common stock. What term would you use for the amoritzation of this premium of $11.40 that you have paid?

A. In Northern Natural?

Q. In Northern Natural.

A. I would assume that if I could get a reliable engineering estimate as to the term of years that would expire prior to the exhaustion of the reserves, that that would have to be used in my calculation.

Q. Yes.

At any rate, there isn't any question but that an investor would have to amortize this premium of $11.40 certainly over some period and, as you have said, probably over the period of the life of the natural gas resources of the company. Is that right?

A. That is right. He wants to, when the thing has wound up, get his capital back and meanwhile have had a reasonable return thereon.

Q. Now, it is equally true, is it not, that if this investor in the common stock of Northern Natural Gas Company [fol. 7034] were to want to ascertain his true earnings on this common stock, he would have to take into consideration the amortization of the $11.40 premium, would he not?

A. Yes, he would take that into consideration although, as we know, common stockholders just do not keep their accounts that way, at least I have never heard of any that did.

Q. Well, let's take a large insurance company that have staffs for that purpose. You would expect that they would certainly go through the calculation to make certain that they had amortized the premium, wouldn't they?

A. I am not sure that insurance companies do that. I wouldn't want to say that they did or didn't. Most common-stockholders don't. As a matter of fact, I never heard of one that did.

Q. Well, whether the investor actually sits down and works out the calculation, he certainly has uppermost in his mind, whenever he thinks in terms of true yield and true earnings, the giving of effect to the amortization out of his gross earnings from the start, the premium of $11.40 which he has paid. Is that right?

A. Well, actually he doesn't do it that way, but he could, I mean just as you or I can make the calculation, but actually he doesn't do it.

Q. Well, as the Vice President of a large firm, to-wit, [fol. 7035] Standard and Poor's, which advises investors and acts as counsel to investors, you would certainly advise investors to take this situation into account, would you not, to determine his true yield?

A. I do not know as we ever have, because, after all, we have never, so far as I have known, contended that a common stock was exactly like a preferred stock which is callable, or a bond, not to my knowledge.

Now, if the company has, I must beg off on innocence but I do not know of any such thing.

Q. Well, the logic is the same, isn't it?

A. Well, I wouldn't quite say that; at least, answering it again, the investors have never believed it to be so.

Q. But if you wanted to be exact about the matter, if you own a share of common stock in Northern Natural Gas Company and you wanted to determine precisely what your true earnings were, you would make the calculation, wouldn't you?

A. Well, with the exception of a few companies, Mr. Littman, the common-stock dividends, as we know, jump all over the lot from one year to another in distinction to your interest on your bond and your preferred dividend on your preferred stock.

That is what the investor has to contend with. That is [fol. 7036] the kind of security he bought. One year they may give him $3 in dividends, the next year it may be $1.50, all depending on earnings, so that it is rather difficult to work your situation out on a mathematical scale such as you could a sinking fund bond or a sinking fund preferred stock.

Here again, it is not quite so simple.

Q. Well, would you please answer my specific question?
A. I thought I did.

Will you read the question, please?

(Whereupon, that question at Line 15, Page 7035 of this record was read by the reporter.)

The Witness: If the situation on a common stock were just exactly as you said, a regular dividend each year of $2, a finite term of 15 years for certain, and all other items just as you said, I would believe it possible, but taking the actuality as you find in the market in common stocks, I would say no.

I think you could not do it with any degree of ease or accuracy.

Q. But in buying this share of common stock of Northern Natural, you would certainly be aware of the fact that you would somehow have to amortize this $11.40 through the dividends received, wouldn't you?
A. I would hope, as I believe the average common [fol. 7037] stockholder does, that over the period of years that he holds this common stock there will be enough return in dividends plus what he receives, if any, in liquidation, should he hang on that long, to give him his principal complete and the equivalent of a fair return thereon.

That is actually the way the investors look at common stocks today.

Q. And that is how they look at common stocks where they pay a premium over and above the book value of that common stock. Isn't that true?
A. Well, as a matter of fact, very few stocks sell at their par value and the only place you would ever have the question to begin with would be in a new issue.

The rest of the investors that we are talking about are not buying new issues, they are buying a share on the New York Stock Exchange which has long since been outstanding and been up in price and down in price.

Q. Now, confining ourselves, for the moment, to Northern Natural Gas Company, this is a new issue that we are speaking of, isnt that right?

A. That is correct.

Q. And there isn't any question in your mind that those individuals who invested their hard-earned cash in Northern Natural's common stock and [payed] a premium of $11.40 over par had in mind very definitely the earning of [fol. 7038] a return that would not only compensate them for the use of their money, but which would amortize that $11.40. Isn't that right?

A. That is correct.

Mr. Culton: Mr. Littman, you said that was a new issue of Northern Natural stock. When was it dated? I was under the impression that that was the issue that was sold by one of the owners.

Mr. Littman: September 10, 1941, as reported in Chart No. 21.

Mr. Culton: Is that the date the stock was issued?

Mr. Littman: I read from the caption of Chart No. 21 of Exhibit No. 65—

Mr. Culton: (Interposing) I know when it was offered to the public, but when was the stock actually issued?

Mr. Littman: Maybe the witness can enlighten us on that, if there is any question.

The Witness: The stock was authorized and issued sometime before that, I forget the date, but this was the first offering to the public of a portion of the over-all issued and outstanding some years prior.

Mr. Culton: The offering has not been by Northern Natural, as I understood it, but by the owning company. I may be mistaken as to that.

The Witness: No, I believe that is correct.

[fol. 7039] By Mr. Littman:

Q. Well now, would anything that Mr. Culton has called to your attention—

Mr. Culton: (Interposing) I just wanted to correct your statement that it was a fresh issue of actual stock.

The Witness: I understand, by listening to this, that you were not using "issue" in the technical sense as we say "authorized and issued".

You are referring to it as this quantity of shares that was then being made available to the public. That was my interpretation rather than pinning it to the technical use of "issue".

By Mr. Littman:

Q. That is right.

Now, looking at your Chart No. 21 of Exhibit No. 65, you have shown in that chart an earnings-price ratio for Northern Natural Gas Company based on the price to the public after the earnings are adjusted to reflect an increase in taxes under [they] Revenue Act of 1941 of 10.89 percent. Is that right?

A. That is correct.

Q. Now, the true return and the true appraisal of risk to the investor is something less than 10.38 percent, is it not?

A. Well, if you are following the same basis that you [fol. 7040] wish to amortize the situation, why, you can pack it down between the two items, but I still contend that it is a purely theoretical condition that you cannot find to exist.

Q. Well, what is theoretical about an investor paying out $11.40 in cold cash for a premium that he knows he can never get back except through the medium of dividends?

What is theoretical about that?

A. Well, I answer you in this fashion, that you have many oil companies, for example, that have gone along for years and never paid a dividend. Then, they paid one.

I would not know, as a holder of that common stock, whether I should, because of an expiration of years with no dividends, take that entire dividend and credit it against my premium or whether I should do as you want me to do, take one-fifteenth and say that applies as against the premium and the rest as against income.

I do not know how the investor does it. As a matter of fact, I know he doesn't do it. It is very difficult thing to do, except in your own hypothetical situation.

Q. Are you suggesting by your last answer, Mr. Coffman, that the investor should use the first dividends that he

receives for amortization purposes and then, after having amortized his premium, to receive a return on his investment?

A. I did not make any such suggestion, but in many common stock situations it would have been wise had a [fol. 7041] man done that, because many a company winds up with no liquidation and even many a going concern today under the Commission's rulings is saying there is no equity in the common stock. Well, who knows.

Q. Well now, there isn't any question, is there, Mr. Coffman, in your opinion, that this 10.38 percent figure shown in Chart No. 21 as the earnings-price ratio for Northern Natural Gas Company's common stock does not reflect the true yield to the public?

A. Yes, it includes the entire yield at the moment and I say that unless Northern Natural finds itself in a position exactly as you have enumerated that it would be difficult to apply an amortization scheme such as you propose.

Q. Regardless of how difficult it may be, regardless of how difficult the calculation, in truth and in fact this 10.38 percent upon which you relied in making your estimate contains and reflects a rate sufficient to amortize the premium of $11.40 which the investor has paid on this common stock. Isn't that true?

A. I still say that that is not true, Mr. Littman, and for several reasons.

I want to go back again to make it clear about the analysis between a bond and preferred stock which is callable. Those two items are set up a good many times on a certain [fol. 7042] schedule of life which may or may not be related to your natural resources.

An equity holder, on the other hand, puts money into this business and if he does not receive it back in the form of large dividends over a period of years, but such earnings are retained in the business to finance new purchases, so long as gas might be available on purchase or otherwise to this company, not from its own reserves, but from any reserves which they might lease or buy in the territory, the equity holder then is in perpetuity, not for the length of the preferred stock and its callable date, not for the maturity date of the bond, and that is the difference.

You cannot issue a bond in a natural resource company without taking the immediate reserves into consideration and it would be rather unfortunate to issue a preferred stock.

I just want to be sure that you understand my point of view. I have just stated it, I think, pretty clearly.

Q. I will understand your point of view, Mr. Coffman, only when you tell me how this investor is going to get back his $11.40 from any other source or in any other way than from this 10.38 percent, so-called, earnings-price ratio. How is he going to get it?

A. If he can take the dividends as they come, he can do the best he can to work out some amortization scale if he likes. In a hazardous industry, however, I as ad-[fol. 7043] visor would be perfectly willing to tell him that he might take all his dividends and accumulate them until it met his par and then when that was doing anything over that he had would begin to look like a return. I would call that a good, conservative practice.

Q. Well then, you are stating, of course, that this 10.38 percent earnings-price ratio on the common stock of Northern Natural Gas Company includes gross, the over-all earnings to the investor, including the amount that he is going to have to use to amortize his premium, isn't that right?

A. For his premium, but that still is separate and apart from the principal amount that he invested. The premium he paid is only one portion and a very small part of the total he paid and he expects to get his principal back, too.

Q. He can get that back on liquidation, can he not?

A. We are not at all sure of that. There are not very many companies that liquidate and pay 100 percent on the common stock. They have no claim whatsoever.

Q. That is all he can hope to get back, isn't it, his par value?

A. If they have retained earnings in the company, no, not at all. If they have distributed all of the earnings as they have gone along he must have some accumula-[fol. 7044] tion there to distribute.

Q. But your earnings as you use them in these charts include all the earnings available for common stock. Isn't that right? A. But not distributed.

Q. Well, whether distributed or not distributed, this 10.38 percent reflects all the earnings?

A. All the earnings available for the stock.

Q. Whether it is paid out in dividends or not paid out in dividends?

A. That is right, so it cannot include dividends. The reason I bring it up is that when you tell me to amortize something, I have nothing to amortize as high as a stockholder gets a dividend.

Not for one minute will I think of amortizing earnings that the company was keeping and not distributing to me, not on your life.

When they give me my capital back in the form of a dividend, I will be willing to talk business with you.

Q. Are you saying that the stockholder is never going to get back even this 10.38 percent?

A. I am saying until it is distributed I do not know and he does not either. That is a management policy. They can pay a dividend or not as they see fit, unless the Commission wants to step in and tell them to or a stock- [fol. 7045] holder brings a suit and forces them to.

Q. Tell me how this investor is going to get back the $11.40 of premium that he paid on this common stock, if he is not going to get it back through this 10.38 percent.

A. Well, in the first place, as I have just tried to explain to you, the 10.38 percent is not going to be all distributed, at least it has not been in most companies and I would not suppose it was here, so he will get only a portion of that in a dividend.

Now, if it is regular and he wants to work out an amortization schedule, he can try it, but it is not a very simple thing.

Q. Mr. Coffman, I have a very simple question and I think it can be answered very easily. My question is simply this:

The amortization of this premium of $11.40 must come out of the 10.38 percent yield, must it not? Yes or no?

A. It will come out of there when it is paid. I want to get it in the payment there because it is pretty important to the investor, if you don't mind.